

ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/

Form 10-Q

November 09, 2016

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 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 September 30, 2016 or

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

For the transition period from _____ to _____

001-9731

(Commission file No.)

ARRHYTHMIA RESEARCH TECHNOLOGY, INC.

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

72 0925679

(I.R.S. employer identification no.)

25 Sawyer Passway

Fitchburg, Massachusetts 01420

(Address of principal executive offices and zip code)

(978) 345-5000

(Registrant's telephone number, including area code)

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer Accelerated filer Non Accelerated filer Smaller reporting company

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

As of November 9, 2016 there were 2,816,639 shares of the Company's common stock outstanding.

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Arrhythmia Research Technology, Inc. and Subsidiaries

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PART I - CONDENSED FINANCIAL STATEMENTS

Item 1. Condensed Consolidated Financial Statements (unaudited)

Arrhythmia Research Technology, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(unaudited)

	September 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 206,619	\$ 272,291
Trade accounts receivable, net of allowance for doubtful accounts of \$30,000 at September 30, 2016 and \$60,000 at December 31, 2015	2,367,370	2,798,353
Inventories	3,144,471	2,118,712
Prepaid expenses and other current assets	745,082	614,129
Total current assets	6,463,542	5,803,485
Property, plant and equipment, net	6,544,711	6,626,069
Assets held for sale, net	665,000	665,000
Intangible assets, net	17,327	18,645
Other assets	237,305	268,835
Total assets	\$ 13,927,885	\$ 13,382,034
Liabilities and Shareholders' Equity		
Current liabilities:		
Revolving line of credit, current portion	\$ 1,546,495	\$ —
Equipment line of credit, current portion	—	35,718
Term notes payable, current portion	771,645	589,635
Subordinated promissory notes	493,898	473,135
Accounts payable	1,964,666	1,553,388
Accrued expenses and other current liabilities	310,390	275,777
Customer deposits	417,966	93,407
Deferred revenue, current	246,657	272,837
Total current liabilities	5,751,717	3,293,897
Long-term liabilities:		

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Revolving line of credit, non-current portion	—	1,511,495
Equipment line of credit, non-current portion	—	301,132
Term notes payable, non-current portion	1,342,443	1,120,652
Deferred revenue, non-current	255,412	272,181
Total long-term liabilities	1,597,855	3,205,460
Total liabilities	7,349,572	6,499,357
Commitments and Contingencies		
Shareholders' equity:		
Preferred stock, \$0.001 par value; 2,000,000 shares authorized, none issued	—	—
Common stock, \$0.01 par value; 10,000,000 shares authorized; 3,926,491 issued, 2,816,639 outstanding at September 30, 2016 and 3,926,491 issued, 2,801,639 outstanding at December 31, 2015	39,265	39,265
Additional paid-in-capital	11,426,837	11,381,536
Treasury stock at cost, 1,109,852 shares at September 30, 2016 and 1,124,852 shares at December 31, 2015	(3,028,564)	(3,069,496)
Accumulated deficit	(1,859,225)	(1,468,628)
Total shareholders' equity	6,578,313	6,882,677
Total liabilities and shareholders' equity	\$ 13,927,885	\$ 13,382,034

See accompanying notes to condensed consolidated financial statements.

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Arrhythmia Research Technology, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net sales	\$ 4,713,123	\$ 5,226,135	\$ 14,825,417	\$ 16,743,571
Cost of sales	3,902,363	4,508,622	12,384,788	14,197,508
Gross profit	810,760	717,513	2,440,629	2,546,063
Selling and marketing	303,279	219,895	900,189	740,476
General and administrative	482,115	651,669	1,664,182	1,825,473
Research and development	24,534	48,007	74,792	202,792
Total operating expenses	809,928	919,571	2,639,163	2,768,741
Net income (loss) from continuing operations	832	(202,058)	(198,534)	(222,678)
Other expense:				
Interest expense	(69,596)	(66,602)	(193,092)	(202,135)
Other income, net	202	3,033	1,029	19,864
Total other expense, net	(69,394)	(63,569)	(192,063)	(182,271)
Income (loss) from continuing operations before income taxes	(68,562)	(265,627)	(390,597)	(404,949)
Income tax provision	—	—	—	—
Income (loss) from continuing operations	(68,562)	(265,627)	(390,597)	(404,949)
Discontinued Operations:				
Income from discontinued operations, net of tax provision of \$0 for the three and nine months ended September 30, 2016 and 2015	—	—	—	362,610
Net income (loss)	\$ (68,562)	\$ (265,627)	\$ (390,597)	\$ (42,339)
Earnings (loss) per share - basic				
Continuing operations	\$ (0.02)	\$ (0.10)	\$ (0.14)	\$ (0.15)
Discontinued operations	—	—	—	0.13
Earnings (loss) per share - basic	\$ (0.02)	\$ (0.10)	\$ (0.14)	\$ (0.02)
Earnings (loss) per share - diluted				
Continuing operations	\$ (0.02)	\$ (0.10)	\$ (0.14)	\$ (0.15)
Discontinued operations	—	—	—	0.13
Earnings (loss) per share - diluted	\$ (0.02)	\$ (0.10)	\$ (0.14)	\$ (0.02)
Weighted average common shares outstanding - basic	2,816,639	2,786,539	2,816,475	2,782,452

Weighted average common shares outstanding - diluted	2,816,639	2,786,539	2,816,475	2,782,452
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See accompanying notes to condensed consolidated financial statements.

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Arrhythmia Research Technology, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(unaudited)

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net income (loss)	\$ (390,597)	\$ (42,339)
Income from discontinued operations	—	(362,610)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
(Gain) loss on sale of property, plant and equipment	—	(17,143)
Depreciation and amortization	1,152,001	1,102,428
Impairment of intangibles	—	118,318
Non-cash interest expense	20,762	20,762
Change in allowance for doubtful accounts	(30,000)	3,000
Share-based compensation expense	35,083	23,416
Changes in operating assets and liabilities:		
Accounts receivable	460,983	128,961
Inventories	(1,025,759)	56,996
Prepaid expenses and other current assets	(130,953)	(276,904)
Other non-current assets	31,530	230,325
Accounts payable	411,278	19,387
Accrued expenses and other current liabilities	332,993	98,516
Other non-current liabilities	(16,769)	(256,870)
Net cash provided by (used in) operating activities	850,552	846,243
Cash flows from investing activities:		
Purchases of property, plant and equipment	(1,069,325)	(1,072,347)
Proceeds from sale of property, plant and equipment	—	35,700
Cash paid for patents and trademarks	—	(6,176)
Net cash provided by (used in) investing activities	(1,069,325)	(1,042,823)
Cash flows from financing activities:		
Proceeds from (payments on) revolving line of credit, net	35,000	190,000
Proceeds from equipment line of credit	544,851	415,785
Payments on term notes payable	(477,900)	(383,376)
Proceeds from stock option exercises	51,150	28,611
Net cash provided by (used in) financing activities	153,101	251,020
Net increase (decrease) in cash and cash equivalents	(65,672)	54,440

Cash and cash equivalents, beginning of period	272,291	209,398
Cash and cash equivalents, end of period	206,619	263,838

Supplemental Cash Flow Information	Nine Months Ended	
	September 30,	
	2016	2015
Cash paid for interest	\$ 173,035	\$ 171,040
Non-cash activities:		
Equipment line of credit converted to term notes payable	\$ 881,701	\$ 415,785

See accompanying notes to condensed consolidated financial statements.

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Arrhythmia Research Technology, Inc. and Subsidiaries

Period Ended September 30, 2016

Notes to the Condensed Consolidated Financial Statements (unaudited)

1. Basis of Presentation

The consolidated financial statements (the "financial statements") include the accounts of Arrhythmia Research Technology, Inc.® ("ART") and its subsidiary, Micron Products, Inc.® ("Micron" and together with ART, the "Company"). ART discontinued operations of its wholly-owned Pennsylvania subsidiary, RMDDxUSA Corp. ("RMDDxUSA") and that subsidiary's Prince Edward Island subsidiary, RMDDx Corporation ("RMDDx" and collectively with RMDDxUSA, "WirelessDx") in the third quarter of 2012. In May 2014, RMDDxUSA filed for bankruptcy and the Chapter 7 discharge order was issued on March 20, 2015 and the case was closed (see Note 10). The WirelessDx results are presented herein as discontinued operations. All intercompany balances and transactions have been eliminated in consolidation.

The unaudited interim condensed consolidated financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, certain information and footnote disclosures normally included in complete financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been omitted pursuant to such rules and regulations. These financial statements and related notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC on March 10, 2016.

The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. The Company's balance sheet at December 31, 2015 has been derived from the audited financial statements at that date, but does not include all the information and footnotes required by GAAP for complete financial statements.

The information presented reflects, in the opinion of the management of the Company, all adjustments necessary for a fair presentation of the financial results for the interim periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Earnings per Share ("EPS")

Basic earnings (loss) per share is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding. The computation of diluted earnings (loss) per share is similar to the computation of basic earnings (loss) per share except that the denominator is increased to include the average number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. In addition, the numerator is adjusted for any changes in net income (loss) that would result from the assumed conversions of those potential shares. For the three and nine months ended September 30, 2016 and 2015 all shares are anti-dilutive. For this reason the EPS table has been removed.

3. Inventories

Inventories consist of the following:

	September 30, 2016	December 31, 2015
Raw materials	\$ 977,277	\$ 775,427
Work-in-process	709,140	265,113
Finished goods	1,458,054	1,078,172
Total	\$ 3,144,471	\$ 2,118,712

Silver included in raw materials, work-in-process and finished goods inventory had an estimated cost of \$607,700 and \$313,738 as of September 30, 2016 and December 31, 2015, respectively.

In the third quarter the Company entered into multi-year agreements with certain offshore customers resulting in increased inventory as of September 30, 2016.

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Arrhythmia Research Technology, Inc. and Subsidiaries

Period Ended September 30, 2016

Notes to the Condensed Consolidated Financial Statements (unaudited)

4. Property, Plant and Equipment, net

Property, plant and equipment, net consist of the following:

	Asset Lives (in years)	September 30, 2016	December 31, 2015
Machinery and equipment	3 to 15	\$ 16,724,913	\$ 15,168,377
Building and improvements	5 to 25	3,986,715	3,978,387
Vehicles	3 to 5	90,713	90,713
Furniture, fixtures, computers and software	3 to 5	1,505,275	1,437,692
Construction in progress		39,223	682,069
Total property, plant and equipment		22,346,839	21,357,238
Less: accumulated depreciation		(15,802,128)	(14,731,169)
Property, plant and equipment, net		\$ 6,544,711	\$ 6,626,069

For the three months ended September 30, 2016 and 2015, the Company recorded depreciation expense of \$406,122 and \$371,606, respectively. For the nine months ended September 30, 2016 and 2015, the Company recorded depreciation expense of \$1,150,683 and \$1,099,632, respectively.

On December 4, 2015, the Company entered into a Letter of Intent to sell its two unoccupied buildings, with a total of approximately 52,000 square feet, and land, at its Fitchburg, Massachusetts campus. On January 13, 2016, the Company entered into a Purchase and Sale Agreement to sell these two buildings which have been classified as Assets Held for Sale at September 30, 2016 and December 31, 2015. The carrying value of the properties (\$665,000) approximated the fair value less the cost to sell. The Company originally expected the sale of the properties to be completed by the end of 2016; however, due to ongoing renegotiations, the Company now expects the sale to occur by the end of 2017. The Company does not expect any material impact on the statement of operations.

5. Intangible Assets, net

The Company assesses the impairment of long-lived assets and intangible assets with finite lives annually or whenever events or changes in circumstances indicate that the carrying value may not be fully recoverable. For the nine months ended September 30, 2016 and 2015, the Company recorded impairment charges of \$0 and \$118,318, respectively.

Intangible assets consist of the following:

	Estimated Useful Life (in years)	September 30, 2016			December 31, 2015		
		Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Patents and trademarks	10	\$ 26,626	9,299	\$ 17,327	\$ 26,626	\$ 7,981	\$ 18,645
Total intangible assets		\$ 26,626	\$ 9,299	\$ 17,327	\$ 26,626	\$ 7,981	\$ 18,645

For the three months ended September 30, 2016 and 2015, the Company recorded amortization expense of \$439 and \$808, respectively. For the nine months ended September 30, 2016 and 2015, the Company recorded amortization expense of \$1,318 and \$2,796, respectively.

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Arrhythmia Research Technology, Inc. and Subsidiaries

Period Ended September 30, 2016

Notes to the Condensed Consolidated Financial Statements (unaudited)

6. Debt

The following table sets forth the items which comprise debt for the Company:

	September 30, 2016	December 31, 2015
Revolving line of credit	\$ 1,546,495	\$ 1,511,495
Equipment line of credit	\$ —	\$ 336,850
Subordinated promissory notes	\$ 493,898	\$ 473,135
Term notes payable:		
Commercial term loan	\$ 483,908	\$ 714,175
Equipment term loans	1,556,283	879,898
Equipment notes	73,897	116,214
Total term notes payable	\$ 2,114,088	\$ 1,710,287
Total Debt	\$ 4,154,481	\$ 4,031,767

Bank Debt

The revolving line of credit (the "revolver"), equipment line of credit, commercial term loan, and three equipment term loans are all under the terms of a multi-year credit facility with a bank as detailed below. The debt is secured by substantially all assets of the Company with the exception of real property.

Revolver

The revolver provides for borrowings up to 80% of eligible accounts receivable and 50% of eligible raw materials inventory. The interest rate on the revolver is calculated at the bank's prime rate plus 0.25% (3.75% at September 30, 2016). The revolver has a maturity date of June 2017. Amounts available to borrow under the revolver are \$398,528 at September 30, 2016.

Commercial term loan

The commercial term loan has a five year term with a maturity date in March 2018. The commercial loan requires monthly payments of approximately \$28,000, consisting of principal and interest at a fixed rate of 4.25%.

Equipment line of credit and equipment term loans

On March 29, 2013, the Company entered into an equipment line of credit that allowed for advances of up to \$1.0 million and included a one-year draw period during which payments were interest only. The draw period ended March 29, 2014 and the then outstanding balance on the equipment line of credit of \$740,999 was converted to an equipment term loan with a five-year term, maturing as of March 29, 2019. The equipment term loan requires monthly payments of approximately \$14,000, consisting of principal and interest at a fixed rate of 4.65%.

On June 26, 2014, the Company entered into an equipment line of credit that allowed for advances of up to \$1.0 million and included a one-year draw period during which payments were interest only. The draw period ended June 26, 2015 and the then outstanding balance on the equipment line of credit of \$415,785 was converted to an equipment term loan with a five-year term, maturing as of June 26, 2020. The equipment term loan requires monthly payments of approximately \$8,000, consisting of principal and interest at a fixed rate of 4.67%.

On June 19, 2015, the Company entered into an equipment line of credit that allowed for advances of up to \$1.0 million and included a one-year draw period during which payments were interest only. The draw period ended June 20, 2016 and the then outstanding balance on the equipment line of credit of \$881,701 was converted to an equipment term loan with a five-year term, maturing as of June 19, 2021. The equipment term loan requires monthly payments of approximately \$17,000, consisting of principal and interest at a fixed rate of 4.68%.

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Arrhythmia Research Technology, Inc. and Subsidiaries

Period Ended September 30, 2016

Notes to the Condensed Consolidated Financial Statements (unaudited)

Other Debt

Equipment notes

In January 2013, the Company entered into two equipment notes totaling \$272,500 with a financing company to acquire production equipment. The notes bear interest at the fixed rate of 4.66% and require monthly payments of principal and interest of approximately \$5,000 over a five year term maturing in January 2018.

Subordinated promissory notes

In December 2013, the Company completed a private offering in which the Company sold an aggregate of \$500,000 in subordinated promissory notes. The notes are unsecured and require quarterly interest-only payments at a rate of 10% per annum for the first two years, increasing to 12% per annum in December 2015. The notes mature in December 2016 at which point the outstanding balance is due in full. The subordinated promissory notes may be prepaid by the Company at any time following the first anniversary thereof without penalty. The notes are subordinated to all indebtedness of the Company pursuant to the bank credit facility.

In connection with the subordinated promissory notes, the Company issued warrants to purchase the Company's common stock at \$3.51 per share. The warrants expire in December 2016. The proceeds were allocated between the notes and warrants on a relative fair value basis resulting in \$416,950 allocated to the notes and \$83,050 allocated to the warrants as part of Additional-Paid-in-Capital. The total discount on the notes is being recognized as non-cash interest expense over the term of the notes. The Company recorded \$6,921 and \$20,763 for the three and nine months ended September 30, 2016 and 2015 of non-cash interest expense related to the amortization of the discount. The unamortized discount which is net against the outstanding balance of the subordinated promissory notes is \$6,102 at September 30, 2016 and \$26,865 at December 31, 2015.

In October 2016, certain of these promissory notes and the unexercised warrants were amended to extend their maturity dates to December 2018 (Note 11).

7. Income Taxes

No provision for income taxes has been recorded in the three or nine months ended September 30, 2016 or 2015, respectively. The Company has a full valuation allowance against its deferred tax assets as of September 30, 2016 and December 31, 2015.

The Company has federal and state net operating loss carryforwards totaling \$8,439,000 and \$8,150,000, respectively, which begin to expire in 2030. The Company also has federal and state tax credit carryovers of \$303,000 and \$340,000 respectively. The federal and state tax credits begin to expire in 2029 and 2016, respectively.

8. Commitments and Contingencies

Legal matters

In the ordinary course of its business, the Company is involved in various legal proceedings involving a variety of matters. The Company does not believe there are any pending legal proceedings that will have a material impact on the Company's financial position or results of operations.

Off-balance sheet arrangements

In the second quarter of 2016 the Company consolidated its operating leases. Lease expense under all operating leases was approximately \$6,009 and \$3,322 for the three months ended September 30, 2016 and 2015, respectively. For the nine months ended September 30, 2016 and 2015 the lease expense was \$14,444 and \$7,966, respectively.

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Arrhythmia Research Technology, Inc. and Subsidiaries

Period Ended September 30, 2016

Notes to the Condensed Consolidated Financial Statements (unaudited)

9. Stock Options and Share-Based Incentive Plan

Options

The following table sets forth the stock option transactions for the nine months ended September 30, 2016:

	Number of options	Weighted Average Exercise Price	Weighted average remaining contractual term (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2015	184,500	\$ 6.21	6.80	\$ 235,293
Granted	5,000	4.50		
Exercised	(15,000)	3.41		
Forfeited	—	—		
Expired	—	—		
Outstanding at September 30, 2016	174,500	6.40	6.73	\$ 30,240
Exercisable at September 30, 2016	92,500	\$ 7.25	5.18	\$ 13,560
Exercisable at December 31, 2015	83,500	\$ 6.60	4.73	\$ 106,565

For the nine months ended September 30, 2016 and 2015, share-based compensation expense related to stock options amounted to \$35,083 and \$23,416, respectively, and is included in general and administrative expenses.

For the nine months ended September 30, 2016, 5,000 options were granted, no options expired and no options were forfeited. There were 15,000 options exercised generating proceeds of \$51,150.

For the nine months ended September 30, 2015, 25,000 options were granted and 15,500 options were forfeited. Additionally, 8,200 options were exercised generating proceeds of \$28,611.

Warrants

For the three and nine months ended September 30, 2016 and 2015, there were no warrants exercised. As of September 30, 2016, 70,000 warrants remain unexercised. The warrants expire in December 2016. In October 2016, the unexercised warrants were amended to extend their maturity dates to December 2018 (Note 11).

10. Discontinued Operations

The Company's subsidiary, RMDDxUSA Corp. and its Prince Edward Island subsidiary RMDDx Corporation (collectively "WirelessDx"), discontinued operations in 2012, filed for relief under Chapter 7 (Liquidation) of the United States Bankruptcy Code in 2014 and on March 20, 2015, the Chapter 7 Order was formally discharged and the case was closed.

For the three and nine months ended September 30, 2015, net income of \$362,610 was recorded from discontinued operations as a result of the write-off of the remaining liabilities of \$320,056 and the reversal of accumulated other comprehensive income of \$42,553 from cumulative translation adjustments from RMDDx Corporation.

11. Subsequent Events

Subordinated promissory notes

On October 11, 2016, the Company, with the consent of all seven investors, amended the terms of its \$500,000 Subordinated Promissory Notes ("Notes") and warrants to purchase common stock ("Warrants"), which were originally issued as part of private offering on December 19, 2013. The investors were provided with the option to extend the maturity date of their Notes and the expiration date of their unexercised Warrants.

Six of the seven investors agreed to extend the maturity dates of their respective Notes, in the aggregate amount of \$450,000, from December 18, 2016 to December 31, 2018. Additionally, the December 18, 2016 expiration date of the 70,000 unexercised

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Arrhythmia Research Technology, Inc. and Subsidiaries

Period Ended September 30, 2016

Notes to the Condensed Consolidated Financial Statements (unaudited)

Warrants was also extended to December 31, 2018. The terms of the \$50,000 Note of the investor electing not to extend remains unchanged and remains payable on December 18, 2016. This investor has no unexercised Warrants.

The extended Notes will bear interest on the unpaid principal at a simple annual interest rate equal to 10% per annum during the extension period, December 19, 2016 to December 31, 2018. Interest only shall be payable in cash on a quarterly basis. Each investor entered into a Subordination Agreement with the initial offering which remains in effect throughout the extension period. The Subordination Agreements provide that the indebtedness pursuant to the Notes shall be subordinated to all indebtedness of the Company pursuant to its multi-year credit facility with a Massachusetts based bank.

The initial offering provided that for every \$50,000 in principal amount of Note, each investor received a Warrant to purchase 10,000 shares of common stock. The Warrants as amended are exercisable during the period commencing six months after issuance and for five years from issuance, at an exercise price equal to \$3.51 per share, namely, the closing market price of the Company's common stock on the day prior to the closing date of the offering.

The Company calculated the incremental fair value of extending the expiration date of the Notes and Warrants and determined that the amendment represented a debt modification in accordance the guidance outlined in ASC-470, "Debt". Using the Black-Scholes model, and the 10% test, the Company determined that the incremental fair value of the warrants to be \$15,818, which will be recorded as a discount against the Notes Payable and an increase in Additional Paid-in Capital.

Bank debt

In October 2016, the Company received a commitment letter from its Massachusetts based bank which outlines proposed terms to refinance the Company's term debt subject to the terms and conditions and assumptions outlined therein. The proposed terms include consolidating the Company's outstanding commercial term loan, three equipment term loans and \$500,000 from the revolver to create a single term note of approximately \$2.6 million. In addition the proposal includes a new \$1.0 million equipment line of credit and a \$500,000 revolver over-advance feature which is contingent upon approval of a working capital guarantee program through the Massachusetts economic development and finance agency. The over-advance feature will provide guarantees to the bank on advances on accounts receivable aged between 90 and 180 days. Some of the Company's off-shore product deliveries

take weeks to arrive at foreign ports and the related credit terms are extended accordingly. The over-advance feature is beneficial to the Company because it adds these type of accounts to the Company's borrowing base.

The proposed agreement is expected to contain both financial and non-financial covenants that are substantially the same as the existing bank agreement. The Company expects to close on the new agreement in the fourth quarter of 2016.

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

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements that involve a number of risks and uncertainties. There are a number of factors that could cause the Company's actual results to differ materially from those forecasted or projected in such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date hereof. The Company is under no obligation and does not intend to update, revise or otherwise publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of any unanticipated events. More information about factors that potentially could affect the Company's financial results is included in the Company's filings with the SEC, including its Annual Report on Form 10-K for the year ended December 31, 2015.

Critical Accounting Policies

The critical accounting policies utilized by the Company in preparation of the accompanying financial statements are set forth in Part II, Item 7 of the Company's Annual Report on Form 10-K for the year ended December 31, 2015, under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations". There have been no material changes to these policies since the year ended December 31, 2015 as filed with the SEC on March 10, 2016.

Overview

Arrhythmia Research Technology®, Inc., a Delaware corporation ("ART"), through its wholly-owned Massachusetts subsidiary, Micron Products®, Inc. ("Micron" and together with ART, the "Company"), is a diversified contract manufacturing organization ("CMO") that produces highly-engineered, innovative medical device components requiring precision machining and injection molding. The Company also manufactures components, devices and equipment for military, law enforcement, automotive and consumer product applications. The Company is engaged in the production and sale of silver/silver chloride coated and conductive resin sensors used as consumable component parts in the manufacture of integrated disposable electrophysiological sensors. These disposable medical devices are used worldwide in the monitoring of electrical signals in various medical applications. The Company's machining operations produce quick-turn, high volume patient-specific and off-the-shelf orthopedic implants and instruments. The Company's machining operations also include laser marking, automated polishing, passivation and coating. The Company has thermoplastic injection molding capabilities as well, and provides a full array of design, engineering, production services and management. The Company competes globally, with approximately thirty five

percent of its revenue derived from exports.

The Company's subsidiary, RMDDxUSA Corp. and its Prince Edward Island subsidiary RMDDx Corporation (collectively "WirelessDx"), discontinued operations in 2012, filed for relief under Chapter 7 (Liquidation) of the United States Bankruptcy Code in May 2014 and in March 2015, the Chapter 7 Order was formally discharged and the case was closed.

Results of Operations

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

Three Months Ended September 30, 2016	Nine Months Ended September 30,
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