COMPUMED INC
Form 10-Q
February 17, 2009

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

# FORM 10-Q

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

For the quarterly period ended: **December 31, 2008**

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from: _____ to _____

**COMPUMED, INC.**

*(Exact name of registrant as specified in its charter)*

| **Delaware** | **000-14210** | **95-2860434** |
|---|---|---|
| *(State or Other Jurisdiction of Incorporation)* | *(Commission File Number)* | *(I.R.S. Employer Identification No.)* |

**5777 West Century Blvd. , Suite 360, Los Angeles, CA 90045**

*(Address of Principal Executive Office) (Zip Code)*

**(310) 258-5000**

*(Registrant s telephone number, including area code)*

**N/A**

*(Former name, former address and former fiscal year, if changed since last report)*

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 X Yes No for the past 90 days.

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

| | | | |
|---|---|---|---|
| Large accelerated filer | | Accelerated filer | |
| Non-accelerated filer | | Smaller reporting company | X |

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

The number of shares outstanding of the registrant s common stock as of January 31, 2009 was 25,882,643.

**COMPUMED, INC. AND SUBSIDIARIES**

**TABLE OF CONTENTS**

Part II. Other Information

i

## PART I - FINANCIAL INFORMATION

**Item 1.**

**Financial Statements.**

**BALANCE SHEETS**
**COMPUMED, INC.**

| | December 31, 2008 (Unaudited) | September 30, 2008 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | 92,000 | 269,000 |
| Investments, at fair market value | 138,000 | 137,000 |
| Accounts receivable, less allowance of $19,000 at December 31, 2008 and September 30, 2008 | 310,000 | 282,000 |
| Other receivables | 5,000 | 5,000 |
| Inventory | 27,000 | 35,000 |
| Prepaid expenses and other current assets | 24,000 | 18,000 |
| TOTAL CURRENT ASSETS | 596,000 | 746,000 |
| | | |
| PROPERTY AND EQUIPMENT | | |
| Machinery and equipment | 1,379,000 | 1,412,000 |
| Furniture, fixtures and leasehold improvements | 76,000 | 76,000 |
| Equipment under capital leases | 438,000 | 391,000 |
| | 1,893,000 | 1,879,000 |
| Accumulated depreciation and amortization | (1,492,000 ) | (1,457,000 ) |
| TOTAL PROPERTY AND EQUIPMENT | 401,000 | 422,000 |
| OTHER ASSETS | | |
| Patents, net of accumulated amortization of $22,000 (December 2008) and $20,000 (September 2008) | 122,000 | 124,000 |
| Other assets | 17,000 | 18,000 |
| TOTAL OTHER ASSETS | 139,000 | 142,000 |
| TOTAL ASSETS | 1,136,000 | 1,310,000 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |

| | | |
|---|---|---|
| CURRENT LIABILITIES | | |
| Accounts payable | 95,000 | 258,000 |
| Accrued liabilities | 214,000 | 158,000 |
| Unearned revenue- ECG processing | 2,000 | 2,000 |
| Current portion of capital lease obligations | 91,000 | 88,000 |
| TOTAL CURRENT LIABILITIES | 402,000 | 506,000 |
| Capital lease obligations | 131,000 | 91,000 |
| TOTAL LIABILITIES | 533,000 | 597,000 |
| STOCKHOLDERS' EQUITY | | |
| Preferred Stock, $0.10 par value - authorized 1,000,000 shares | | |
| Preferred Stock- Class A $3.50 cumulative convertible voting - | | |
| issued and outstanding - 8,400 shares | 1,000 | 1,000 |
| Preferred Stock- Class B $3.50 cumulative convertible voting - | | |
| issued and outstanding - 300 shares | | |
| Preferred Stock- Class D 2% convertible - | | |
| issued and outstanding - 4,167 shares | | |
| Common Stock, $0.01 par value - authorized 50,000,000 shares, issued and outstanding - 25,882,643 (December 2008) and 24,939,283 shares (September 2008) | 260,000 | 260,000 |
| Additional paid-in capital | 36,395,000 | 36,363,000 |
| Accumulated deficit | (36,053,000 ) | (35,911,000 ) |
| TOTAL STOCKHOLDERS' EQUITY | 603,000 | 713,000 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | 1,136,000 | 1,310,000 |

**STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**
**(UNAUDITED)**
**COMPUMED, INC.**

| | Three Months Ending December 31, | |
|---|---|---|
| | **2008** | **2007** |
| REVENUE | | |
| ECG services | 432,000 | 482,000 |
| ECG product and supplies sales | 40,000 | 60,000 |
| OsteoGram ® and Osteometer sales and services | 67,000 | 46,000 |
| TOTAL REVENUE | 539,000 | 588,000 |
| OPERATING EXPENSES | | |
| Costs of ECG services | 192,000 | 208,000 |
| Cost of goods sold-ECG | 28,000 | 42,000 |
| Cost of goods sold - OsteoGram ® and Osteometer | | 2,000 |
| Selling expenses | 102,000 | 116,000 |
| Research and development | 27,000 | 110,000 |
| General and administrative expenses | 275,000 | 492,000 |
| Depreciation and amortization | 38,000 | 24,000 |
| TOTAL OPERATING EXPENSES | 662,000 | 994,000 |
| | | |
| OPERATING LOSS | (123,000 ) | (406,000 ) |
| | | |
| Interest income and dividends | 1,000 | 21,000 |
| Realized gain (loss) on marketable securities | | (52,000 ) |
| Interest expense | (20,000 ) | (4,000 ) |
| NET LOSS | (142,000 ) | (441,000 ) |
| | | |
| OTHER COMPREHENSIVE INCOME | | |
| Unrealized gain/(loss) in marketable securities | | (5,000 ) |
| Reclassification adjustment for marketable securities sold | | 52,000 |
| TOTAL OTHER COMPREHENSIVE INCOME | | 47,000 |

| | | |
|---|---|---|
| TOTAL COMPREHENSIVE LOSS | (142,000 ) | (394,000 ) |
| NET LOSS PER COMMON SHARES (BASIC AND DILUTED) | (0.01 ) | (0.02 ) |
| Weighted average number of common shares outstanding | 25,882,643 | 24,939,283 |

**STATEMENTS OF CASH FLOWS**
**(UNAUDITED)**
**COMPUMED, INC.**

| | Three Months Ending December 31, | |
|---|---|---|
| | **2008** | **2007** |
| OPERATING ACTIVITIES: | | |
| Net loss | (142,000 ) | (441,000 ) |
| Net adjustments to reconcile net loss to net cash used in operating activities: | | |
| Realized (gain)/loss on marketable securities | | 52,000 |
| Stock-based compensation | 32,000 | 78,000 |
| Depreciation and amortization | 37,000 | 24,000 |
| (Increase)/Decrease in accounts receivable | (28,000 ) | (104,000 ) |
| (Increase)/Decrease in inventory and prepaid expenses | 2,000 | (45,000 ) |
| Increase/(Decrease) in accounts payable and other liabilities | (49,000 ) | 7,000 |
| NET CASH USED IN OPERATING ACTIVITIES | (148,000 ) | (429,000 ) |
| | | |
| CASH FLOW FROM INVESTING ACTIVITIES: | | |
| Proceeds from sale of marketable securities | | 513,000 |
| Purchase of marketable securities | (1,000 ) | (600,000 ) |
| Purchase of other asset | | (9,000 ) |
| Purchase of property, plant and equipment | (3,000 ) | (37,000 ) |
| NET CASH USED IN INVESTING ACTIVITIES | (4,000 ) | (133,000 ) |
| | | |
| CASH FLOW FROM FINANCING ACTIVITIES: | | |
| Payments on capital lease obligations | (25,000 ) | (15,000 ) |
| NET CASH USED IN FINANCING ACTIVITIES | (25,000 ) | (15,000 ) |
| | | |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (177,000 ) | (577,000 ) |
| | | |
| CASH AND CASH EQUVALENTS AT BEGINNING OF PERIOD | 269,000 | 969,000 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | 92,000 | 392,000 |
| | | |
| SUPPLEMENTAL DISCLOSURES: | | |
| Interest paid | 10,000 | 5,000 |
| Equipment acquired under capital lease | 47,000 | 68,000 |

**NOTES TO FINANCIAL STATEMENTS (UNAUDITED)**
**COMPUMED, INC.**

**NOTE A - BASIS OF PRESENTATION AND ACCOUNTING POLICIES**

Description of Business: CompuMed, Inc. (the Company) is a medical diagnostic product and services company focusing on the diagnosis, monitoring and management of several costly, high incidence diseases, particularly cardiovascular disease and osteoporosis. The Company's primary business is the development and marketing of its osteoporosis testing technology OsteoGram (R) and the computer interpretation of electrocardiograms ("ECGs"). The Company applies advanced computing, medical imaging, telecommunications and networking technologies to provide medical professionals and patients with affordable, point-of-care solutions for disease risk assessment and decision support.

Liquidity and Capital Resources

The accompanying interim unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three-month period ended December 31, 2008 are not necessarily indicative of the results that may be expected for the year ending September 30, 2009. For further information, refer to the financial statements for the year ended September 30, 2008 and the notes thereto included in the Company's Annual Report on Form 10-KSB.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. This basis of accounting contemplates the recovery of the Company's assets and the satisfaction of its liabilities in the normal course of conducting its business. The Company's ability to continue as a going concern is dependent upon various factors including, among others, its ability to reduce its operating losses and negative cash flows, and the ability to draw from our existing revolving line of credit or other sources of financing. However, the Company has made significant progress towards reducing its cash burn during the last two quarters of fiscal 2008 and sustained in the first quarter of 2009 where we used $148,000 of cash for operating activities compared to $429,000 for the same period in fiscal 2008. This was accomplished due to a continued overall cost cutting initiatives and our efforts around higher margin portions of our business. The Company is continually assessing the performance of its product lines and business units and may engage in further cost-cutting measures as well as other possible strategic transactions involving third parties for any non-performing product line, with a goal to achieve cash flow positive status as soon as possible. The Company used existing cash and readily available marketable securities balances to fund operating losses and capital expenditures. The Company has raised funds from 1997 through 2008 through stock issuances and proceeds from the exercise of certain stock options and warrants. The Company also raised funds through an Investment Agreement with Dutchess Private Equities Fund. This Investment Agreement expired March 25, 2007, and was not renewed. Currently, the Company is secured by a $4M revolving line of credit pursuant to the Amended Credit Agreement entered in December 16, 2008.

The balance sheet at September 30, 2008 has been derived from the Company's year-end audited financial statements but does not include all of the information and footnotes required by accounting principles generally accepted in the

United States for complete financial statements. The Company generated negative cash flows from operations and had net losses of $142,000 and $441,000 in the three-month period ending December 31, 2008 and 2007, respectively. However, the Company has implemented a significant campaign of cost reductions, and we anticipate that it will result in improved cash flows from operations. The Company also has available a revolving line of credit under which it can draw funds for working capital purposes.

Management believes the Company will be able to generate sufficient revenue, reduce operating expenses or obtain financing in order to fund ongoing operations for at least the next twelve months. Accordingly, the financial statements do not include any adjustments to reflect the possible future effects on the recoverability or classifications of assets and liabilities that may result from the outcome of this uncertainty.

On March 14, 2007, the Company closed a private placement of its securities to an institutional investor pursuant to the Securities Purchase Agreement. The Company sold to the investor 4,167 Units at a price of $480 per Unit resulting in total proceeds of $2,000,000. Each Unit consisted of 1 share of the Company s Class D Preferred

Stock as well as 1,000 Common Stock Purchase Warrants at an exercise price of $0.30 per share. Pursuant to the Agreement, the Company issued all 4,167 shares of the authorized Class D Preferred Stock. Each share of Class D Preferred Stock is convertible at any time into 2,000 shares of the Company s common stock. The holder of each issued and outstanding share of Class D Preferred Stock will be entitled to receive a dividend in respect of each such share at the rate per share of $9.60 per annum**,** payable on each of the first, second, third, and fourth anniversaries of March 12, 2007, commencing March 12, 2008. Dividend payments to each holder will be made in shares of the Company s common stock valued at the average Market Price over 20 trading days, as defined in the Certificate of Designation. In the event the dividends may not lawfully be paid by the issuance of the Company s common stock and may be lawfully paid in cash, the dividends will be paid in cash. In fiscal 2008, we issued 121,775 shares of common stock to pay for dividends due March 12 2008. In the event of any liquidation, dissolution or winding-up, either voluntarily or involuntarily, the holders of shares of the Class D Preferred Stock then issued and outstanding will be entitled to be paid out of the Company s assets available for distribution to its stockholders, whether from capital, surplus or earnings, before any payment shall be made to the holders of shares of the Company s common stock or upon any other series of the Company s Preferred Stock with a liquidation preference subordinate to the liquidation preference of Class D Preferred Stock, an amount per share equal to $480 plus the dollar amount equal to all unpaid and accrued dividends and interest thereon. In addition, a merger or consolidation with or into any other corporation, or a sale, lease, exchange, or transfer of all or any part of the Company s assets will be deemed a liquidation event unless no assets are distributed in respect of any class of the Company s capital stock in connection with, or as a result of, such merger or consolidation. The Class D Preferred Stock has the same voting rights as the Company s common stock except that each share of Class D Preferred Stock is entitled to 2,000 votes for vote allowed a share of the Company s common stock, however such amount will be proportionally adjusted in the event of a reverse or forward split of the Company s common stock.

On February 15, 2008, the Company entered into a revolving line of credit agreement (the "Credit Agreement") between the Company, as Borrower, and Boston Avenue Capital, LLC, an Oklahoma limited liability company, as Lender (the "Lender" or "BAC"). The Credit Agreement provided for a new revolving line of credit facility in an aggregate principal amount of up to $4 million. The revolving line of credit matures on December 31, 2017. Advances under the revolving line of credit bear interest at the current three-month London Interbank Offered Rate (LIBOR), payable quarterly in arrears for the prior fiscal quarter on the fifth business day of each January, April, July and October, commencing on April 7, 2008. The Credit Agreement also provided that unused amounts up to the total commitment bear interest at a rate of one percent (1%) per annum, compounded annually on the first business day of each calendar year. Under the Credit Agreement, the Lender provided the Company a letter of credit issued by JP Morgan Chase NA in an amount at all times equal to the amount of (i) $4,000,000 less (ii) the aggregate amount of advances then outstanding under the revolving line of credit. Advances under the revolving line of credit were unsecured senior obligations of the Company.

The Credit Agreement contained customary representations and warranties of the Company. Availability under the new revolving line of credit is subject to certain conditions, including (i) certain covenants relating to the composition of the Board of Directors of the Company, (ii) that the members of the Board of Directors of the Company unanimously approve any advance, (iii) that there not be any undisclosed material liabilities at the time of an advance, and (iv) that the Lender shall have consented (in its sole discretion) in the event that an advance is requested and, at the time of the request for the advance, the Company or any of its officers, directors, employees, shareholders or affiliates is a party to any pending legal proceedings related to the Company or its affiliates.

The February 15, 2008 revolving line of credit facility could be prepaid at any time in whole or in part without premium or penalty, other than payment of the 1% commitment interest on unused advances if the commitment is not terminated.

The Credit Agreement also included certain customary events of default including, but not limited to: failure to pay principal or interest when due (subject to grace period); any representation or warranty proving to have been materially incorrect when made or confirmed; failure to perform or observe covenants set forth in the Credit Agreement; and bankruptcy and insolvency defaults.

Board Agreement

On February 15, 2008, the Company entered into an Agreement (the "Board Agreement") among the Company, BAC and Robert Stuckelman, John Minnick, John Romm, M.D., and Stuart Silverman, M.D., each a member of the board of directors of the Company (each of Messrs. Stuckelman, Minnick, Romm and Silverman

being collectively referred to as the "Resigning Board Members"). Pursuant to the terms of the Board Agreement, BAC and the Company terminated certain agreements dated May 17, 2007 relating to the rights and obligations of BAC and the Company regarding voting and otherwise supporting the nominations of members of the Board of Directors of the Company. In addition, the Board Agreement required that each of the Resigning Board Members submit his resignation as a board member of the Company concurrently with the execution thereof, and each of BAC and the Resigning Board Members executed and delivered a mutual general release of claims against each other. The Board Agreement was a condition of BAC's willingness to enter into the Credit Agreement.

On December 16, 2008, the Company entered into an amended revolving line of credit agreement (the Amended Credit Agreement ) between the Company, as Borrower, and Boston Avenue Capital, LLC, an Oklahoma limited liability company, as Lender (the Lender or BAC ). The Amended Credit Agreement amends the original credit agreement entered into between Borrower and Lender dated February 15, 2008 (the Original Credit Agreement ).

The Amended Credit Agreement provides a credit facility in an aggregate principal amount of up to $4 million. Advances under the revolving line of credit shall bear interest at the current three-month London Interbank Offered Rate (LIBOR), payable quarterly in arrears for the prior fiscal quarter on the fifth business day of each January, April, July and October commencing after the first advance. The Amended Credit Agreement provides that unused amounts up to the total commitment shall bear interest at a rate of one percent (1%) per annum, compounded annually on the first business day of each calendar year. BAC is not required to maintain a third party letter of credit in support of the Amended Credit Agreement. Borrower may, at any time, reduce the total amount of the Letter of Credit (as hereafter provided) by written notice to the Lender and the issuer thereof and no Commitment Interest or other fee or charge shall be due or payable by Borrower in respect of the amount by which the Letter of Credit is so reduced. The Amended Credit Agreement matures on December 31, 2010.

The Amended Credit Agreement terminates the 16,000,000 warrants (the Original Warrants ) issued to BAC as consideration for the Original Credit Agreement. The Original Warrants were granted i) at a variable price based on the trading of the stock price and ii) regardless of whether an advance was made under the Original Credit Agreement. Under the Amended Credit Agreement, the Company will issue 16,000,000 warrants (the New Warrants ) to BAC for a purchase price of $5,000 only if, and after, an advance of funds under the Amended Credit Agreement occurs. The strike price of the New Warrants is fixed at two dollars ($2.00) each. The New Warrants may only be issued upon shareholder approval, which the Company must use its best efforts to obtain before the second anniversary of any advance.

The Amended Credit Agreement contains customary representations and warranties of the Company. Availability under the new revolving line of credit is subject to certain conditions, including (i) that the existing board member of the Company and other directors approved by the Lender comprise all of the directors of the Company, (ii) that the members of the board of directors of the Company unanimously approve any advance, (iii) that there not be any undisclosed material liabilities at the time of an advance, and (iv) that the Lender shall have consented (in its sole discretion) in the event that an advance is requested and, at the time of the request for the advance, the Company or any of its officers, directors, employees, shareholders or affiliates is a party to any pending legal proceedings related to the Company or its affiliates.

Advances under the Amended Credit Agreement may be prepaid at any time in whole or in part without premium or penalty. The Amended Credit Agreement also includes certain customary events of default including, but not limited to: Failure to pay principal or interest when due (subject to grace period); any representation or warranty proving to have been materially incorrect when made or confirmed; failure to perform or observe covenants set for the in the

Amended Credits Agreement; and bankruptcy and insolvency defaults.

On November 4, 2008, the Board of Directors of the Company approved the Amended Credit Agreement, with Mr. Chuck Gillman, the manager of BAC, abstaining.

As of December 31, 2008, there was no draw made against the revolving line of credit.

**STOCK-BASED COMPENSATION**

Prior to October 1, 2006, the Company accounted for employee stock option grants in accordance with APB No. 25, and adopted the disclosure-only provisions of SFAS No.123, Accounting for Stock-Based

Compensation, amended by SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure.

Effective October 1, 2006, the Company adopted SFAS No. 123R using the modified prospective method. Under this method, compensation cost recognized includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of October 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123 amortized over the options' vesting period, and (b) compensation cost for all share-based payments granted subsequent to October 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R amortized on a straight-line basis over the options' vesting period.

The expected stock volatility rates are based on the historical stock volatility of the Company s common stock. The risk free interest rates are based on the U.S. Treasury yield curve in effect at the time of the grant for periods corresponding to the expected life of the option. The Company has opted to use the simplified method as allowed by Staff Accounting Bulletin ( SAB ) 107 for estimating our expected term to arrive at a term in between the vesting period and the contractual term.

There were no grants issued during the three months ended December 31, 2008 and 2007.

A summary of the stock options activity and related information for the three months ended December 31 follows:

| | 2008 | | 2007 | |
|---|---|---|---|---|
| | Shares | Weighted-Average Exercise Price | Shares | Weighted-Average Exercise Price |
| Options outstanding, beginning of period | 8,748,248 | 0.30 | 11,237,414 | 0.29 |
| Options exercised | | | | |
| Options granted | | | | |
| Options forfeited/canceled | (300,000 ) | 0.35 | (133,333 ) | 0.29 |
| Options outstanding, end of period | 8,448,248 | 0.30 | 11,104,081 | 0.29 |
| Options exercisable, end of period | 7,311,586 | 0.30 | 5,189,086 | 0.28 |

The following summarizes information concerning stock options outstanding at December 31, 2008:

| Range of Exercise Prices | Shares Outstanding | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price of Shares Outstanding | Shares Exercisable | Weighted Average Exercise Price of Shares Exercisable |
|---|---|---|---|---|---|

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| $ | 0.0000 - $0.4250 | 7,467,648 | 6.87 | $ | 0.26 | 6,330,986 | $ 0.25 |
| $ | 0.4251 - $0.8500 | 970,600 | 2.38 | $ | 0.66 | 970,600 | $ 0.66 |
| $ | 0.8501 - $1.2750 | 10,000 | 1.33 | $ | 0.95 | 10,000 | $ 0.95 |
| | | 8,448,248 | 6.34 | $ | 0.30 | 7,311,586 | $ 0.30 |

**PER SHARE DATA**

The Company reports its earnings (loss) per share in accordance with Statement of Financial Accounting Standards No. 128, "Accounting for Earnings Per Share" ("SFAS 128"). Basic loss per share is calculated using the net loss divided by the weighted average common shares outstanding. Shares from the assumed conversion of outstanding warrants, options and the effect of the conversion of the Class A Preferred Stock and Class B Preferred Stock are omitted from the computations of diluted loss per share because the effect would be anti-dilutive.

| | |
|---|---|
| Net loss | (142,000 ) |
| Less: preferred stock dividends | (1,000 ) |
| Net loss available to common stockholders | (143,000 ) |
| | |
| Net loss per common share (basic and diluted) | $ (0.01 ) |
| Weighted average number of common shares outstanding | 25,882,643 |

**NEW ACCOUNTING PRONOUNCEMENT**

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. For financial assets and liabilities, SFAS 157 will be effective for the Company in the first fiscal quarter of 2009. As permitted by FSP-FAS 157-2, SFAS 157 is effective for nonfinancial assets and liabilities for the Company during the first fiscal quarter of 2010. Management believes the adoption of SFAS 157 for its financial assets and liabilities will not have a material impact on the Company's financial statements and continues to evaluate the potential impact of the adoption of SFAS 157 related to its nonfinancial assets and liabilities.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"). SFAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value. SFAS 159 will be effective for the Company in the first fiscal quarter of 2009. The Company believes the adoption of SFAS 159 will not have a material impact on the Company's financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS 141R"), which replaces SFAS 141. SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any resulting goodwill, and any noncontrolling interest in the acquiree. SFAS 141R also provides for disclosures to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R will be effective for the Company in first fiscal quarter of 2010 and must be applied prospectively to business combinations completed on or after that date.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements -- an amendment of Accounting Research Bulletin No. 51" ("SFAS 160"), which establishes accounting and reporting standards for noncontrolling interests ("minority interests") in subsidiaries. SFAS 160 clarifies that a noncontrolling interest in a subsidiary should be accounted for as a component of equity separate from the parent's equity. SFAS 160 will be effective for the Company in the first fiscal quarter of 2010 and must be applied prospectively, except for the presentation and disclosure requirements, which will apply retrospectively. The Company is currently evaluating the

potential impact that the adoption of SFAS 160 may have on its financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities -- an amendment of FASB Statement No. 133" ("SFAS 161"), which requires enhanced disclosures about an entity's derivative and hedging activities. SFAS 161 will be effective for the Company during the second fiscal quarter of 2009.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)", ("SFAS 158"), which requires the recognition of the overfunded or underfunded status of a defined benefit postretirement plan in a company's balance sheet. This portion of the new guidance is effective on December 31, 2006. Additionally, the pronouncement eliminates the option for companies to use a measurement date prior to their fiscal year-end effective December 31, 2008. Since we do not have any defined benefit pension or postretirement plans that are subject to SFAS 158, we do not expect the pronouncement to have a material impact on our financial statements.

In June 2006, the Financial Accounting Standards Board ("FASB) issued FASB interpretation No. 48, "Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109" ("FIN 48"), which clarifies the accounting for uncertainty in income tax positions. The provisions of FIN 48 were effective for the Company on October 1, 2007, with the cumulative effect of the change in accounting principle, if any, recorded as an adjustment to opening retained earnings. After evaluating the adoption of FIN 48, we believe that the adoption did not have a material impact on our financial statements.

**NOTE B - OTHER AGREEMENTS**

On March 14, 2007, the Company closed a private placement of its securities to an institutional investor pursuant to the Securities Purchase Agreement. The Company sold to the investor 4,167 Units at a price of $480 per Unit resulting in total proceeds of $2,000,000. Each Unit consisted of 1 share of the Company s Class D Preferred Stock as well as 1,000 Common Stock Purchase Warrants with an exercise price of $0.30 per share. Pursuant to the Agreement, the Company issued all 4,167 shares of the authorized Class D Preferred Stock. Each share of Class D Preferred Stock is convertible at any time into 2,000 shares of the Company s common stock. The holder of each issued and outstanding share of Class D Preferred Stock will be entitled to receive a dividend in respect of each such share at the rate per share of $9.60 per annum**,** payable on each of the first, second, third, and fourth anniversaries of March 12, 2007, commencing March 12, 2008. Dividend payments to each holder will be made in shares of the Company s common stock valued at the average Market Price over 20 trading days, as defined in the Certificate of Designation. In the event the dividends may not lawfully be paid by the issuance of the Company s common stock and may be lawfully paid in cash, the dividends will be paid in cash. The Company accrued the March 2008 dividend on the Class D Preferred Stock and paid in shares of its common stock in August 2008. While the Company expects that it will have sufficient shares of common stock authorized to pay the next scheduled dividend on the Class D Preferred Stock in shares of its common stock, the Company currently will not have sufficient authorized shares to continue to pay dividends in shares of common stock in the future unless and until the stockholders authorize additional shares. In the event of any liquidation, dissolution or winding-up, either voluntarily or involuntarily, the holders of shares of the Class D Preferred Stock then issued and outstanding will be entitled to be paid out of the Company s assets available for distribution to its stockholders, whether from capital, surplus or earnings, before any payment shall be made to the holders of shares of the Company s common stock or upon any other series of the Company s Preferred Stock with a liquidation preference subordinate to the liquidation preference of Class D Preferred Stock, an amount per share equal to $480 plus the dollar amount equal to all unpaid and accrued dividends and interest thereon. In addition, a merger or consolidation with or into any other corporation, or a sale, lease, exchange, or transfer of all or any part of the Company s assets will deemed a liquidation event unless no assets are distributed in respect of any class of the Company s capital stock in connection with, or as a result of, such merger or consolidation. The Class D Preferred Stock has the same voting rights as the Company s common stock except that each share of Class D Preferred Stock is entitled to 2,000 votes for vote allowed a share of the Company s common stock, however such amount will be proportionally adjusted in the event of a reverse or forward split of the Company s common stock.

On June 7, 2007 we amended the contract with Synthetica (America), Ltd. to retain Mr. Maurizio Vecchione for the position of Interim Chief Executive Officer. Under the terms of this Amendment, Mr. Vecchione, while part-time, will spend sufficient time at the Company to discharge the duties needed of the CEO. Maurizio Vecchione is a Managing Partner of Synthetica Holdings, LLC, a private equity and venture fund, and the Chairman of Synthetica (America), Ltd., a management consultant previously retained to provide strategic advice to CompuMed. Mr. Vecchione co-founded and joined Synthetica in September 2001. He also serves as Chairman of The IDEAS Studio, a

multimedia content company in the educational field and Interim CEO of Mobile Video Development Corporation, an early stage company in wireless video technology. As part of his duties at Synthetica he has held various executive positions with Synthetica client companies including from July 2004 to September 2006 Mr. Vecchione served as CEO of Trestle Holdings, Inc., a medical imaging company for digital pathology and a company for which he orchestrated a restructuring and the sale of its operating assets. From April 2003 to July 2004, Mr. Vecchione was President and CEO of Microwave Photonics, Inc., a wireless technology company based on technology acquired from British Telecommunications Plc. Prior to joining Synthetica he was the founder and co-CEO of imaging rendering company ModaCAD Inc. (later Styleclick, Inc.) and lead the company from 1983 through 2001, when he orchestrated its sale to USA Networks (now InterActiveCorp.).

On February 15, 2008, CompuMed, Inc., a Delaware corporation (the "Company"), entered into a revolving line of credit agreement (the "Credit Agreement") between the Company, as Borrower, and Boston Avenue Capital, LLC, an Oklahoma limited liability company, as Lender (the "Lender" or "BAC"). The Credit Agreement provides

for a new revolving line of credit facility in an aggregate principal amount of up to $4 million. The revolving line of credit matures on December 31, 2017. Advances under the revolving line of credit shall bear interest at the current three-month London Interbank Offered Rate (LIBOR), payable quarterly in arrears for the prior fiscal quarter on the fifth business day of each January, April, July and October, commencing on April 7, 2008. The Credit Agreement also provides that unused amounts up to the total commitment shall bear interest at a rate of one percent (1%) per annum, compounded annually on the first business day of each calendar year. Under the Credit Agreement the Lender provided the Company a letter of credit issued by JP Morgan Chase NA in an amount at all times equal to the amount of (i) $4,000,000 less (ii) the aggregate amount of advances then outstanding under the revolving line of credit. Advances under the revolving line of credit will be unsecured senior obligations of the Company. The Company expects to use proceeds under the new revolving line of credit for general corporate purposes, including working capital and to fund new product joint ventures or potential acquisitions consistent with its business strategy.

The Credit Agreement contains customary representations and warranties of the Company. Availability under the new revolving line of credit is subject to certain conditions, including (i) certain covenants relating to the composition of the Board of Directors of the Company, (ii) that the members of the Board of Directors of the Company unanimously approve any advance, (iii) that there not be any undisclosed material liabilities at the time of an advance, and (iv) that the Lender shall have consented (in its sole discretion) in the event that an advance is requested and, at the time of the request for the advance, the Company or any of its officers, directors, employees, shareholders or affiliates is a party to any pending legal proceedings related to the Company or its affiliates.

The new revolving line of credit facility may be prepaid at any time in whole or in part without premium or penalty, other than payment of the 1% commitment interest on unused advances if the commitment is not terminated.

The Credit Agreement also includes certain customary events of default including, but not limited to: failure to pay principal or interest when due (subject to grace period); any representation or warranty proving to have been materially incorrect when made or confirmed; failure to perform or observe covenants set forth in the Credit Agreement; and bankruptcy and insolvency defaults.

Board Agreement

On February 15, 2008, the Company entered into an Agreement (the "Board Agreement") among the Company, BAC and Robert Stuckelman, John Minnick, John Romm, M.D., and Stuart Silverman, M.D., each a member of the board of directors of the Company (each of Messrs. Stuckelman, Minnick, Romm and Silverman being collectively referred to as the "Resigning Board Members"). Pursuant to the terms of the Board Agreement, BAC and the Company terminated certain agreements dated May 17, 2007 relating to the rights and obligations of BAC and the Company regarding voting and otherwise supporting the nominations of members of the Board of Directors of the Company. In addition, the Board Agreement required that each of the Resigning Board Members submit his resignation as a board member of the Company concurrently with the execution thereof, and each of BAC and the Resigning Board Members executed and delivered a mutual general release of claims against each other. The Board Agreement was a condition of BAC's willingness to enter into the Credit Agreement.

On December 16, 2008, the Company entered into an amended revolving line of credit agreement (the Amended Credit Agreement ) between the Company, as Borrower, and Boston Avenue Capital, LLC, an Oklahoma limited liability company, as Lender (the Lender or BAC ). The Amended Credit Agreement amends the original credit agreement entered into between Borrower and Lender dated February 15, 2008 (the Original Credit Agreement ).

The Amended Credit Agreement provides a credit facility in an aggregate principal amount of up to $4 million. Advances under the revolving line of credit shall bear interest at the current three-month London Interbank Offered Rate (LIBOR), payable quarterly in arrears for the prior fiscal quarter on the fifth business day of each January, April, July and October commencing after the first advance. The Amended Credit Agreement provides that unused amounts up to the total commitment shall bear interest at a rate of one percent (1%) per annum, compounded annually on the first business day of each calendar year. BAC is not required to maintain a third party letter of credit in support of the Amended Credit Agreement. Borrower may, at any time, reduce the total amount of the Letter of Credit (as hereafter provided) by written notice to the Lender and the issuer thereof and no Commitment Interest or other fee or charge shall be due or payable by Borrower in respect of the amount by which the Letter of Credit is so reduced. The Amended Credit Agreement matures on December 31, 2010.

The Amended Credit Agreement terminates the 16,000,000 warrants (the Original Warrants ) issued to BAC as consideration for the Original Credit Agreement. The Original Warrants were granted i) at a variable price based on the trading of the stock price and ii) regardless of whether an advance was made under the Original Credit Agreement. Under the Amended Credit Agreement, the Company will issue 16,000,000 warrants (the New Warrants ) to BAC for a purchase price of $5,000 only if, and after, an advance of funds under the Amended Credit Agreement occurs. The strike price of the New Warrants is fixed at two dollars ($2.00) each. The New Warrants may only be issued upon shareholder approval which the Company must use its best efforts to obtain before the second anniversary of any advance.

The Amended Credit Agreement contains customary representations and warranties of the Company. Availability under the new revolving line of credit is subject to certain conditions, including (i) that the existing board member of the Company and other directors approved by the Lender comprise all of the directors of the Company, (ii) that the members of the board of directors of the Company unanimously approve any advance, (iii) that there not be any undisclosed material liabilities at the time of an advance, and (iv) that the Lender shall have consented (in its sole discretion) in the event that an advance is requested and, at the time of the request for the advance, the Company or any of its officers, directors, employees, shareholders or affiliates is a party to any pending legal proceedings related to the Company or its affiliates.

Advances under the Amended Credit Agreement may be prepaid at any time in whole or in part without premium or penalty. The Amended Credit Agreement also includes certain customary events of default including, but not limited to: Failure to pay principal or interest when due (subject to grace period); any representation or warranty proving to have been materially incorrect when made or confirmed; failure to perform or observe covenants set for the in the Amended Credits Agreement; and bankruptcy and insolvency defaults.

On November 4, 2008, the Board of Directors of the Company approved the Amended Credit Agreement, with Mr. Chuck Gillman, the manager of BAC, abstaining.

As of December 31, 2008, there was no draw made against the line of credit.

*Agreement with OSI Optoelectronic Systems*

On May 14, 2008 the Company entered into an agreement with OSI Optoelectonic Systems, a unit of OSI Systems Inc. ( OSI ) whereby the Company would market a bone densitometer manufactured by OSI and based on a peripheral dual energy absorption technology (pDXA). Under the agreement the Company purchases the pDXA products at an agreed transfer price based on forecasted quantities and is free to set a retail price of the units to achieve a target margin. The agreement covers US, Canada and other NAFTA countries. The Company announced the availability of this pDXA bone densitometer under its Osteocare product brand. This product was introduced on May 29, 2008 to provide a point-of-care targeted bone densitometer.

The Company also retained Vici Capital, a company owned by our Director Mark Crockett, for the period of January 7 2009 through September 7 2009, to provide certain investment banking and financial advisory services in connection with potential strategic transactions described in Exhibit 10.26.

11

**NOTE C- COMMITMENTS AND CONTINGENCIES**

The Company has capital leases for machinery and equipment that expire in 2013. On March 1, 2008, the Company entered into a new lease with L.A.T Investment. Under the new lease, the Company moved the corporate office, computer center from its prior 9,496 square feet on the building s twelfth floor to the the new space consisting 10,949 square feet on the building s third floor. The lease term is five years with the option to renew for an additional five-year term. The monthly rent under the new lease is $13,686 for the first year, with 3% increase in the ensuing lease years, plus certain operating expenses. The following is a summary as of December 31, 2008 of future minimum lease payments together with the present value of the net minimum lease payments on capital leases:

| | Capital Lease | Operating Leases |
|---|---|---|
| 2009 | 95,000 | 122,000 |
| 2010 | 81,000 | 171,000 |
| 2011 | 55,000 | 176,000 |
| 2012 | 33,000 | 174,000 |
| 2013 | 14,000 | 71,000 |
| | 278,000 | 714,000 |
| Less amount representing interest | 56,000 | |
| Net minimum lease payment | 222,000 | |
| Less current portion | 91,000 | |
| Present value of net minimum payment, less current portion | 131,000 | |

During the quarter ended December 31, 2008, the Company entered into a capital lease obligation for equipment at the cost of $69,000. This obligation bears an average interest of 16.3 % and a monthly payment of $2,000 and matures in November 2013. The range of interest rates on capital leases outstanding as of December 31, 2008 was 11.93% to 16.53%.

Rental expenses under operating leases for the first quarter ended December 31, 2008 and 2007 were $44,000 and $40,000, respectively.

The holders of Class A Preferred Stock are entitled to receive, when and as declared by the Board of Directors, dividends at an annual rate of $.35 per share, payable quarterly. Dividends are cumulative from the date of issuance. The total dividends accumulated in the quarter ended December 31, 2008 was $1,000 and the total cumulated dividends not declared at December 31, 2008 was $25,000.

12

**Item 2.**

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

**SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS**

This report on Form 10-Q contains forward-looking statements, including, without limitation, statements concerning our possible or assumed future results of operations. These statements are preceded by, followed by or include the words "believes," "could," "expects," "intends," "anticipates," or similar expressions. Our actual results could differ materially from those anticipated in the forward-looking statements for many reasons including, but not limited to, product and service demand and acceptance, changes in technology, ability to raise capital, the availability of appropriate acquisition candidates and/or business partnerships, economic conditions, the impact of competition and pricing, capacity and supply constraints or difficulties, government regulation and other risks described in our annual report on Form 10-K and other reports as may be filed from time to time with the Securities and Exchange Commission. Although we believe the expectations reflected in the forward-looking statements are reasonable, they relate only to events as of the date on which the statements are made, and our future results, levels of activity, performance or achievements may not meet these expectations. We do not intend to update any of the forward-looking statements after the date of this document to conform these statements to actual results or to changes in our expectations, except as required by law.

Statements contained in this 10-Q, such as statements about revenue, operations, and earnings growth and other financial results are forward-looking statements pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All such forward-looking statements including statements concerning the Company's plans, objectives, expectations and intentions are based largely on management s expectations and are subject to and qualified by risks and uncertainties that could cause actual results to differ materially from those expressed or implied by such statements. These statements are subject to uncertainties and risks including, without limitation, product and service demand and acceptance, changes in technology, ability to raise capital, the availability of appropriate acquisition candidates and/or business partnerships, economic conditions, the impact of competition and pricing, capacity and supply constraints or difficulties, government regulation and other risks identified in the Company's filings with the Securities and Exchange Commission. All such forward-looking statements are expressly qualified by these cautionary statements. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements to reflect events, conditions or circumstances on which any such statement is based after the date hereof, except as required by law.

**OVERVIEW**

We develop and market products and services that use advanced imaging and medical informatics to provide analysis and remote monitoring in connection with cardiovascular and musculoskeletal diseases. We have specialized expertise and intellectual properties useful in telemonitoring imaging and analysis designed to improve healthcare provider workflow and patient care, while reducing costs. Our core products, the OsteoGram® and CardioGram™, are cleared by the FDA and reimbursable by Medicare and many private insurers.

*Telecardiology Services*

CardioGram is a telemedicine application focused on tele-cardiology. We have been a supplier of telemedicine services for more than twenty years and have established one of the nation's largest telecommunications networks for processing electrocardiograms on a real time basis, providing ECG equipment and services to more than 1,000 locations throughout the U.S .. and performing nearly 400,000 trans-telephonic ECG interpretations annually. Using our customized electrocardiogram terminals, an electrocardiogram is acquired from a patient, transmitted to our central computers, electronically analyzed and received back on the electrocardiogram terminal where the electrocardiogram trace and computer interpretation are printed- all within a few minutes. If necessary, we can provide an "over-read" by a cardiologist and return the results within a short time-frame. We bill for this service on a per-use basis, and we sell a full range of electrocardiogram supplies including electrodes, recording paper, gel, and patient cables.

During the fiscal year 2008, we completed certain investments in expanding our tele-cardiology and telemedicine platform supporting our CardioGram products which had begun the prior quarter. This expansion focused on continued upgrade of the quality of service associated with our response time and network capacity. We have upgraded many key software components in our servers to improve transmission times and quality of service.

The upgrades completed during fiscal year 2008 were also designed to support the expansion of our

ECG services beyond the traditional markets of correctional facilities into broader tele-medicine and electronic medical records (EMR) markets. We continue to take steps to prepare the launch of an EMR solution applied to telecardiology. We believe that adding such a solution could allow the Company to expand its telecardiology business to new customers.

In October 2008, the Company previewed its new CompuBRIDGE(TM) telecardiology electronic medical records (EMR) solution at the National Conference on Correctional Health Care (NCCHC), in Chicago. The CompuBRIDGE EMR is designed to capture and integrate electrocardiogram (ECG) results and over-reads into an existing EMR system. Integration does not require the practice to employ additional software, hardware or specialized servers. For facilities without a general EMR system, CompuMed expects to offer hosted solutions that provide access to ECG data via any Internet enabled computer. CompuMed expects to release its CompuBRIDGE EMR system after testing with beta customers. CompuBRIDGE EMR could provide users of CompuMed's telecardiology services with the ability to data mine patient records and electronically transfer those records to their own EMR systems, such as patient administrative systems, electronic practice management, laboratory information systems, dietary and pharmacy.

We are currently engaging in discussions about possible joint ventures or other similar relationships with leaders in the EMR space to synergize our telecardiology offering with their integrated EMR systems. We are also exploring whether such EMR offerings could be used by clinical research organizations in support of new drugs development as well as drug safety studies. While we believe that the Company could benefit from such an offering and are actively engaged in planning for such an EMR offering there are no guarantees that the Company will be able to launch such a product or that it will be successful in growing its business with it.

Our transmission revenue is subject to volume volatility due to State budget cycles and other usage factors. During the quarter, some of our core State Department of Corrections customers responded to the global financial crises and its anticipated impact on State budgets by reducing the volume of ECG tests being performed. Some Departments of Corrections went from testing most inmates on receiving to limiting testing to those inmates with certain risk factors. This resulted in a reduction of volume of ECG readings and over-reads per average site from those customers. This reduction was partially offset by an increase of overall number of sites under contract. The Company has responded to these trends by accelerating certain cost reductions as well as continued to focus on marketing strategies designed to expand and differentiate our overall number of customers.

As part of this strategy, we continue to target an expansion of our offering into new markets, including the Federal Government, branches of the U.S. Military, the Veteran s Administration, surgical centers, occupational and rural health centers, mental health centers, as well as additional correctional facilities. All of these sites potentially experience the situation of having to provide time-critical medical response to patients in the midst of a cardiac event without having access to trained cardiologists. We believe, based on market data, that our CardioGram could provide a solution that can elevate the quality of patient care at these institutions and reduce liabilities at these locations.

During the quarter, the Company identified a significant new opportunity to offer ECG over-read services for the pediatric care market. The Company developed during the quarter its CardioGramKids program, which was subsequently launched in January 2009. During the quarter, the Company partnered with the Department of Pediatrics at the University of Miami Miller School of Medicine to provide electrocardiogram (ECG) screening services to children and teenagers prior to prescribing or taking psychotropic medications, including stimulants as well as for pre-athletic screening. This relationship will allow CompuMed to offer remote interpretation of ECGs on pediatric patients in this first-of-its-kind program to detect heart abnormalities prior to therapy. The need for such screening arises in response to the American Heart Association and other leading groups that have expressed concern regarding reports of sudden death in children and adolescents treated with stimulants and other psychotropic medications for

conditions such as attention deficit hyperactivity disorder, commonly referred to as ADHD. Medical journals have also reported concerns regarding the appropriateness of such therapy without screening at risk patients. According to our market research there are about 300,000 specialists (pediatrics, primary care and psychiatry) in the U.S. likely to see patients who might need psychotropic drugs, including stimulants. According to a 2008 report in Child and Adolescent Psychiatry and Mental Health, approximately 6.7 percent of children in the U.S. are taking these medications for emotional and behavioral problems like ADHD. CompuMed s CardioGramKids could enable physicians to screen the children in their care while at the same time offering doctors important protection from potential litigation.

We cannot offer assurance that any of these expansions will be successful in increasing our revenues or producing profits, or that our products will ultimately prove to be effective in these new markets. There can be no assurances that the Company will succeed in keeping or expanding its contracts with its customers and that those customers will not reduce their use of the Company s services in the future.

We compete with multiple companies in the ECG services markets, some of which have considerably more experience and financial resources. We also compete with the suppliers of self-interpreting ECG equipment. Although self-interpreting ECG equipment is widely available, our customers have historically preferred the optional feature of automatically sending their ECG results to one of our cardiologists for an over-read when the results are abnormal and when emergencies arise. We believe that this 24/7 over-read feature is a key advantage that enables us to market our services in segments of the market where physicians or specialists may not be available on a routine basis. We could lose customers who choose to receive services from a competitor or who purchase a self-interpretive machine and no longer need our ECG interpretations. If we were to lose existing customers, they may be difficult to replace, and that could have a material adverse impact on our operations and financial condition.

*Skeletal Health Products*

The Company is active in the Skeletal Health market through two product lines, OsteoCare and OsteoGram.

According to the Bone Health and Osteoporosis report from the U.S. Surgeon General, (Department of Health and Human Services, Bone Health and Osteoporosis, A report of the Surgeon General, 2004), fractures due to bone disease are common, costly and often become a chronic burden on individuals and society. An estimated 1.5 million individuals suffer a bone disease-related fracture annually (Roggs and Melton 1995, Chrischilles 1991). A white woman over the age of 50 has more than a 40 percent chance of suffering a fracture sometime during the rest of her life (Cummings and Melton 2002). Fractures can have devastating consequences for both the individuals who suffer them and their family members. Hip fractures are associated with increased risk of mortality; the risk of mortality is 2.8 to 4 times greater among hip fracture patients during the first 3 months after the fracture than comparable risk among individuals of similar age who live in the community and do not suffer a fracture.

Despite the devastating impact of bone disease and Medicare's stated desire to test more at-risk patients, the Centers for Medicare and Medicaid services recently enacted significant cuts in the reimbursement for central DXA, or dual energy X-ray absorptiometry, a technology which widely used in the United States to perform bone mineral density testing. As a result there have been trends in the marketplace of significant slowing of sales of central DXA systems and the number of centers offering central DXA services appears to be shrinking. Approved reimbursement for alternative screening technologies such as the Company s OsteoGram product was left unchanged. However there is no guarantee that reimbursements for alternative procedures will remain unchanged in the future.

In part because of the changing Medicare reimbursement posture is making the economics of owning and operating a DXA facility less attractive, our market research suggests that there may be a new and growing demand for peripheral bone density measurement machines that can perform the test at point-of-care, in a small physician practice and on an inexpensive desktop device. As a result, we engaged in an aggressive test marketing effort to validate the notion that a point-of-care unit could enhance our product offering and receive favorable market acceptance.

The Company s OsteoGram®, is a high-end bone densitometer principally for OEM use. The OsteoGram is a non-invasive diagnostic system that has been shown in clinical studies to provide an effective and accurate bone density measurement in connection with screening for osteoporosis and assessing hip fracture risk. Our target markets for these products are hospitals, radiology practices, imaging centers, and general OB/GYN and orthopedic office practices. We are now supplying the third generation OsteoGram product. The OsteoGram product is marketed and distributed directly by the Company, and through approved distributors and Original Equipment Manufacturers (OEMs).

Market acceptance of this product has been limited by the fact that the OsteoGram software is a bolt-on to other Digital Radiology (DR) or equivalent systems. While such systems are normally present in large facilities, many of the smaller physician s practices that appear most interested in providing bone density screening to their patients typically do not own such systems, or in many cases do not even own X-Ray equipment. As a result we have not been able to deploy OsteoGram for the point-of-care opportunity discussed above. Recognizing this, the

Company has altered its marketing effort of the OsteoGram to focus on larger facilities with existing DR/CT systems, and introduced an alternate, self-contained product, OsteoCare for the point-of-care market.

OsteoGram is gaining acceptance in China as a result of the regulatory approval by the Chinese State Food and Drug Administration, which was obtained in July 2008. According to China's most recent national census, about 100 million Chinese citizens suffer from the disease in various stages. Additionally in October 2008 one of the largest studies ever done in China on nearly 7,000 patients reaffirmed the accuracy and precision of the OsteoGrams. As a result, during the quarter the volume of sales for OsteoGram from China showed a significant increase. It is too early, however to determine whether such increased revenues will continue.

OsteoGram continues to have limited acceptance at this time. In the US there is a tendency by the physician community to look at RA, the technology on which OsteoGram is based, as a lesser technology than DXA, the prevalent approach to bone densitometry. While this appears to be a perception , it has made sales, especially in the US, difficult. In overseas markets the bias towards DXA is less pronounced and the Company has invested effort towards developing credible international channels and clearing the path towards a greater presence internationally. In order to overcome this perception, and to expand its ability to operate in international markets, the Company has begun investigating strategic alliances with one or more large third parties that could add large company resources to our OsteoGram marketing efforts. It is too early to indicate the form and structure of such a relationship and there can be no guarantees that such a relationship can be found or executed.

The OsteoGram product is a medical image processing software system that enables healthcare providers to screen, diagnose and monitor osteoporosis using digital hand images from filmless x-ray equipment or conventional, film-based x-rays. Osteoporosis is diagnosed by measuring bone mineral density. A low bone mineral density is indicative of the disease. The OsteoGram is based on a bone mass measurement technique called radiographic absorptiometry. Radiographic absorptiometry uses a conventional x-ray of the hand, scanned at high resolution, to measure bone density. The radiographic absorptiometry technique not only measures bone mass, but also the cortical thickness of bones. Recent studies affirm the importance of cortical thickness as an additional measure of bone strength and overall fracture risk. Several prominent pharmaceutical manufacturers are developing products that will strengthen cortical bone. Cortical bone is the outer shell that gives bone strength, much like the hollow tubes from which bicycles are constructed. Our technology has the capability to measure bone mineral density in both cortical and trabecular bone. Dual energy x-ray absorptiometry, or DXA, is considered the "Gold Standard" of bone mineral density measurement, but it cannot differentiate between cortical and trabecular bone.

In May 1999, we received clearance from the United States Food and Drug Administration, or FDA, to market an automated version of the OsteoGram software for use as a stand-alone product by physicians. In 2004, we launched the Digital Imaging and Communications in Medicine, or DICOM, a digital version of the OsteoGram product. Using digital or film-based x-ray equipment, two posterior-anterior views of the left-hand fingers are taken with an aluminum alloy reference wedge in each exposure. The calibration wedge is used to adjust for any differences among x-ray equipment, exposures and other variables. In the case of the film-based version of the OsteoGram, the developed film is scanned with a high-resolution desktop scanner, and the OsteoGram software analysis program rapidly produces an accurate and precise bone mineral density report. With a filmless x-ray system the digital image is captured on a workstation for analysis. We developed the DICOM-compliant version of the OsteoGram for use on filmless systems, which we believe may be a high growth segment in the medical imaging market. DICOM (Digital Imaging and Communications in Medicine) is the industry-consortium established information standard that allows the new generation of digital medical imaging equipment to interconnect.

We continue to believe a new market demand may also be developing from certain digital mammography providers interested in adding the OsteoGram as a complementary screening test on their own full field digital mammography equipments. We are pursuing strategies to align with a market-leading partner and integrate our product into its digital mammography platform or mammography management/networking software. To date these discussions have not resulted in new OEM relationships or materials sales. We are considering aligning with key players in this area as a strategy to energize sales of the OsteoGram product. There can be no guarantees we will succeed in establishing such relationships or sales.

We have to date performed integration tests that have proven the technical feasibility of using the full field digital mammography machine as input to OsteoGram. Such tests have been successful and provide the basis for continued discussions with various prospective partners. In November 2007, our OEM partner FujiMedical showed such a networked integrated system at the Radiologic Society of North America annual meeting in Chicago. The

timing and completion of such negotiations are subject to many factors, including the timing of introduction by those vendors of various models of Full Field Digital Mammography systems and the evolution of the regulatory and reimbursement landscape for such devices. There can be no assurances, however, that we will be successful in accomplishing such a linkage or in building such a business relationship with any such partners and that this strategy will be successful in the marketplace. Commercially launching such an integrated product may also involve obtaining further regulatory approvals, including possibly receiving an FDA 510(k) clearance, which we may not be able to obtain.

In October 2007 the Company was issued US Patent 7280683 for a Method, Code, and System for Assaying Joint Deformity. We believe that the claims underlying this patent have implication in the quantification and measurement of joint disease such as Arthritis. We have been approached by parties associated with pharmaceutical drug discovery and are exploring options to leverage our software and our intellectual properties in this area for a possible joint venture or other business relationship designed to couple our technology with new drugs being introduced in the arthritis area. This could lead to new products as well as new distribution channels and revenue streams. However, there can be no guarantee at this time that such a relationship can be made or that it would be successful.

In May 2008, the Company entered into an agreement with OSI Optoelectonic Systems, a unit of OSI Systems Inc. ( OSI ) whereby the Company would market a bone densitometer manufactured by OSI and based on a peripheral dual energy absorption technology (pDXA). Under the agreement the Company purchases the pDXA products at an agreed transfer price based on forecasted quantities and is free to set a retail price of the units to achieve a target margin. The agreement covers US, Canada and other NAFTA countries. The Company announced the availability of this pDXA bone densitometer under its OsteoCare product brand. This product was introduced on to provide a point-of-care targeted bone densitometer.

Market research done by the Company has suggested OsteoCare can play a role in primary care settings because it: 1) provides a self-contained source of x-rays 2) is based on DXA technology which at this time, enjoys greater acceptance in the primary care field 3) is fully automated and can provide results with minimal physician training or supervision 4) enjoys wide reimbursement from both private insurers and Medicare 5) has a small physical footprint and good ergonomics and 6) can be placed on the market for a total price point well under $15,000, which according to our market research is a key ceiling in order to enable return on investment for an average physician practice. The Company has targeted primary care physicians in the US.

Currently, the marketing plan for OsteoCare involves a physician education campaign which includes a briefing on the importance of screening patients with certain risk factors for Osteoporosis, available treatments courses, a specialist referral network for diagnosed at-risk patients, and a reimbursement guide for the doctor s billing office to follow. During the launch of the new education campaign, OsteoCare has been made available to qualified physician s offices on a free 45-day trial program. Under the trial the physician agrees to take in the unit for the trial period, establish a screening program for its at-risk patient population, bill patients and reimbursers according to our guidelines, and tabulate the results. At the end of the trial the doctor has the option to either buy the machine, lease or rent the machine or return it. To date this program has focused initially on California. The Company has reached out to the primary care community in California through a combination of efforts, including 1) direct sales 2) trade shows and physician s meetings and, 3) telemarketing-. The Company is ranking these practices according to various criteria and placing trial units at their locations. The trial program has shown early evidence of success but it is too early to date to determine with certainty the ultimate success of the program. We have created a significant pipeline of physician practices interested in participating in the trial program. We have also begun converting some of the early trial participants into customers, either on a lease, rental or sale basis. However, the Company has a limited pool of units it can offer for trial due to the cost of building such an inventory. As a result the Company is constantly re-evaluating its

success metrics for this trial program and plans on reviewing its target inventory levels on a quarter to quarter basis. It is currently too early to tell how successful OsteoCare will be in the marketplace and the Company is taking a conservative approach to building its inventory to maximize its cash flow.

One of the key business goals of the OsteoCare product is to build recurring revenue for the Company. As a result the Company is promoting a rental program. Under the rental program the physician rents the unit with a certain contractual term and pays a monthly rate. In turns the Company finances the equipment with a commercial leasing company and keeps the spread between its leasing cost and the rental fee as its margin. This is similar to the arrangements the Company enters into with its telecardiology customers. With this approach, the Company hopes to

create a more predictable revenue stream not subject to the one-time revenues that is traditionally associated with medical device sales. Additionally, the on-going relationship with these doctors allows the Company to manage these physicians as a clinical network and to offer to its network, in the future, other new or expanded products or services in the OsteoCare platform.

While there is evidence that this rental strategy is being accepted in the marketplace, it is too early to validate. Also, because the revenue recognition on these sales will be based on monthly rental amounts, it will take some time before the volume of rental adds up to material amounts. There can be no guarantee that these strategies will develop into a meaningful business or that the Company will ultimately be successful in this program. Also there can be no guarantees that the Company will be able, in the future, to offer additional products to its clinical network.

**RESULTS OF OPERATIONS FOR THE QUARTER ENDED DECEMBER 31, 2008 COMPARED TO THE QUARTER ENDED DECEMBER 31, 2007.**

Total revenues for the quarter were $539,000 compared with $588,000 for the same quarter in 2007. The decrease was due to a decrease in our ECG Product and supplies and in our ECG services revenue business lines, offset by an increase in our Skeletal Health product line.

ECG services revenue, which consists of ECG processing, equipment rental, over-reads and maintenance, during the first quarter of fiscal 2009, decreased by 10.4% to $432,000 from $482,000 for the same period in fiscal 2008 due to lower ECG processing and over-reads volumes at certain Department of Corrections sites due to cost reduction measures in response to certain State budget cuts, partially offset by a higher number of overall sites under contract.

Skeletal Health products (OsteoGram and OsteoCare) revenue for the first quarter of fiscal 2009 increased by 45.7% to $67,000 from $46,000 for the same period in fiscal 2008, due to expansion of sales in China as a result of regulatory clearances in China by the Chinese State Food and Drug Administration.

ECG product and supplies sales, (one time sales of equipment and supplies relating to our ECG services) revenue for the first quarter of fiscal 2009 decreased by 33.3% to $40,000 from $60,000 for the same period in fiscal 2008, due to some State Department of Corrections delaying certain capital purchases due to the global economic downturn and its impact on some state budgets.

Costs of services of ECG for the first quarter of fiscal 2009 decreased by 7.7% to $192,000 from $208,000 for the same period in fiscal 2008, due to lower volume of over-read processing and resulting smaller variable costs from the cardiologists who provide such services.

Cost of goods sold of ECG for the first quarter of fiscal 2009 decreased by 33.3% to $28,000 from $42,000 for the same period in fiscal 2008, in proportion with the decrease in ECG product sales mentioned above.

Cost of goods sold for OsteoGram for the first quarter of fiscal 2009 decreased by 100% to $0 from $2,000 for the same period in fiscal 2008, due to a purchase of special packing labels that were required by our OEM partners for regulatory purposes in fiscal 2008 and no longer required for fiscal 2009.

Selling expenses for the first quarter of fiscal 2009 decreased by 12.1% to $102,000 from $116,000 for the same period in fiscal 2008, due to cost cutting by the Company, and the effect of the re-alignment and cost reductions associated with certain non performing products, specifically in connection with the OsteoGram.

General and administrative expenses for the first quarter of fiscal 2009 decreased by 44.1% to $275,000 from $492,000 for the same period in fiscal 2008. The decrease was due to the continued cost cutting by the company including 19% related to the discontinued board fees of four members who resigned pursuant to the terms of the Board Agreement and Boston Avenue Capital, LLC on February 15, 2008, 20% related to reduction in consulting services, 19% related to the effect of expensing the stock options under SFAS 123R, and 33% related to reduction in professional fees.

Research and development costs for the first quarter of fiscal 2009 decreased by 75.5% to $27,000 from $110,000 for the same period in fiscal 2008 due to the effect of cost reduction stemming from the re-alignment of R&D priorities and the completion of certain product development efforts.

Due to the effect of expensing employee stock options under SFAS 123R starting in October 2006, during the three months ended December 31, 2008 and 2007, the non-cash stock-based compensation charge included in the expenses above was $32,000 and $78,000, respectively.

Interest and dividend income for the first quarter of fiscal 2009 decreased by 95.2% to $1,000 from $21,000 for the same period in fiscal 2008, due to sales of certain marketable securities that earned interest and dividends but may be subject to volatility. The Company invested the proceeds of these marketable securities in mutual funds in accordance to its investment policy.

Interest expense for the first quarter of fiscal 2009 increased by 400% to $20,000 from $4,000 for the same period in fiscal 2008, due to $5,000 in increased in financing related to the purchase of ECG and OsteoMeter equipment and $10,000 in interest accrued on the $4M Revolving Line of Credit pursuant to the Credit Agreement .

Net loss for the first quarter of fiscal 2009 decreased by 67.8% to $142,000 from $441,000 for the same period in fiscal 2008, due to a continued overall cost cutting initiative implemented.

**FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES**

At December 31, 2008, we had $230,000 in cash and marketable securities, as compared to a balance of $406,000 at September 30, 2008, a net decrease of $176,000. This decrease was due to loss in operations. The Company has made significant progress towards reducing its cash burn during the first quarter of 2009 where we used $148,000 of cash for operating activities compared to $429,000 for the same period in fiscal 2008. This was accomplished due to a continued overall cost cutting initiatives and our efforts around higher margin portions of our business. The Company is continually assessing the performance of its product lines and business units and may engage in further cost-cutting measures as well as other possible strategic transactions involving third parties for any non-performing product line, with a goal to achieve cash flow positive status as soon as possible.

A portion of the Company s available capital is currently invested in money market accounts. As of December 31, 2008, the Company s investments in marketable securities were valued at $138,000.

The purchase of property, plant, and equipment paid in cash for the three months ended December 31, 2008 and 2007 was $3,000 and $37,000, respectively.

The Company anticipates that its cash flow from operations, available cash and marketable securities will be sufficient to meet its anticipated financial needs for at least the next 12 months assuming that no significant downturn in its business occurs. There can be no guarantee that the Company will achieve this result, however and the Company may need to raise additional capital in the future or draw down in its available credit line. Such sources of financing might not be available on reasonable terms or at all. Failure to raise capital when needed could adversely impact the Company s business, operating results and liquidity. If additional funds were raised through the issuance of equity securities, the percentage of ownership of existing stockholders would be reduced. Furthermore, these equity securities might have rights, preferences or privileges senior to the Company s common stock. The Company s Common stock is currently quoted on the over-the-counter bulletin board, which will make it more difficult to raise

funds through the issuance of equity securities. These additional sources of financing may not be available on acceptable terms, if at all.

We have historically used existing cash and readily available marketable securities balances to fund operating losses and capital expenditures. We also raise funds through the sale of common and preferred stock and use proceeds from the exercise of stock options and warrants. Additionally we have put in place a credit facility usable for additional liquidity. At this time we have drawn no funds against the credit facility.

Additionally we are exploring joint ventures, acquisitions and other forms of strategic transactions, which might cause us to require additional capital. The Company plans to make use of its existing credit facility for such transactions. However there is no guarantee that the Company will be able to enter in such a transaction or that it would be at terms consistent with the available credit facility.

**CAPITAL COMMITMENTS**

Our primary capital resource commitments at December 31, 2008 consist of capital and operating lease commitments, primarily for computer equipment, electrocardiogram terminals, OsteoMeter machines and for our corporate office facility. On March 1, 2008, the Company entered into an agreement with L.A.T. Investment Corporation for the lease of the corporate office. Under the new lease, the Company moved the corporate offices, computer center and warehouse facilities from its prior 9,496 square feet in the building's 12th floor to new space consisting of 10,949 square feet on the building's third floor. The lease term is five years, with an option for the Company to renew for an additional five-year term. Monthly rent under the new lease is $13,686 during the first year, with 3% annual increases, plus certain operating expenses.

Effective June 1, 2007, we appointed Maurizio Vecchione to the position of Interim Chief Executive Officer. We amended our Consulting Agreement with Synthetica (America), Ltd. to provide the services of Mr. Vecchione in this capacity for consideration of $15,000 per month and 170,000 warrants at $0.29 per share. One third of the warrants vested on June 7, 2007, one third vested at June 7, 2008 and one third will vest on June 7, 2009. These warrants will expire on June 7, 2017. Under the terms of the Amendment, Mr. Vecchione, while part-time, will spend sufficient time at the Company to discharge the duties needed of the CEO.

**FINANCING ACTIVITIES**

On March 14, 2007, we closed a private placement of our securities to an institutional investor pursuant to the Securities Purchase Agreement. We sold to the investor 4,167 Units at a price of $480 per Unit resulting in total proceeds of $2,000,000. Each Unit consisted of 1 share of our Class D Preferred Stock as well as 1,000 Common Stock Purchase Warrants with an exercise price of $0.30 per share. Pursuant to the Agreement, we issued all 4,167 shares of the authorized Class D Preferred Stock. Each share of Class D Preferred Stock is convertible at any time into 2,000 shares of common stock. The holder of each issued and outstanding share of Class D Preferred Stock will be entitled to receive a dividend in respect of each such share at the rate per share of $9.60 per annum, payable on each of the first, second, third, and fourth anniversaries of March 12, 2007, commencing March 12, 2008. Dividend payments to each holder will be made in shares of our common stock valued at the average Market Price over 20 trading days, as defined in the Certificate of Designation. In the event the dividends may not lawfully be paid by the issuance of our common stock and may be lawfully paid in cash, the dividends will be paid in cash. The Company accrued the March 2008 dividend on the Class D Preferred Stock and paid in shares of its common stock in August 2008. While the Company expects that it will have sufficient shares of common stock authorized to pay the next scheduled dividend on the Class D Preferred Stock in shares of its common stock, the Company currently will not have sufficient authorized shares to continue to pay dividends in shares of common stock in the future unless and until the stockholders authorize additional shares. In the event of any liquidation, dissolution or winding-up, either voluntarily or involuntarily, the holders of shares of the Class D Preferred Stock then issued and outstanding will be entitled to be paid out of our assets available for distribution to its stockholders, whether from capital, surplus or earnings, before any payment shall be made to the holders of shares of our common stock or upon any other series of our Preferred Stock with a liquidation preference subordinate to the liquidation preference of Class D Preferred Stock, an amount per share equal to $480 plus the dollar amount equal to all unpaid and accrued dividends and interest thereon. In addition, a merger or consolidation with or into any other corporation, or a sale, lease, exchange, or transfer of all or any part of our assets will be deemed a liquidation event unless no assets are distributed in respect of

any class of our capital stock in connection with, or as a result of, such merger or consolidation.

The Class D Preferred Stock has the same voting rights as our common stock except that each share of Class D Preferred Stock is entitled to 2,000 votes for vote allowed a share of common stock, however such amount will be proportionally adjusted in the event of a reverse or forward split of our common stock.

On February 15, 2008, CompuMed, Inc., a Delaware corporation (the "Company"), entered into a revolving line of credit agreement (the "Credit Agreement") between the Company, as Borrower, and Boston Avenue Capital, LLC, an Oklahoma limited liability company, as Lender (the "Lender" or "BAC"). The Credit Agreement provides for a new revolving line of credit facility in an aggregate principal amount of up to $4 million. The revolving line of credit matures on December 31, 2017. Advances under the revolving line of credit shall bear interest at the current three-month London Interbank Offered Rate (LIBOR), payable quarterly in arrears for the prior fiscal quarter on the fifth business day of each January, April, July and October, commencing on April 7, 2008. The Credit Agreement also provides that unused amounts up to the total commitment shall bear interest at a rate of one percent (1%) per annum, compounded annually on the first business day of each calendar year. Under the Credit Agreement, the

Lender provided the Company a letter of credit issued by JP Morgan Chase NA in an amount at all times equal to the amount of (i) $4,000,000 less (ii) the aggregate amount of advances then outstanding under the revolving line of credit. Advances under the revolving line of credit will be unsecured senior obligations of the Company. The Company expects to use proceeds under the new revolving line of credit for general corporate purposes, including working capital and to fund new product joint ventures or potential acquisitions consistent with its business strategy.

The Credit Agreement contains customary representations and warranties of the Company. Availability under the new revolving line of credit is subject to certain conditions, including (i) certain covenants relating to the composition of the Board of Directors of the Company, (ii) that the members of the Board of Directors of the Company unanimously approve any advance, (iii) that there not be any undisclosed material liabilities at the time of an advance, and (iv) that the Lender shall have consented (in its sole discretion) in the event that an advance is requested and, at the time of the request for the advance, the Company or any of its officers, directors, employees, shareholders or affiliates is a party to any pending legal proceedings related to the Company or its affiliates.

The new revolving line of credit facility may be prepaid at any time in whole or in part without premium or penalty, other than payment of the 1% commitment interest on unused advances if the commitment is not terminated.

The Credit Agreement also includes certain customary events of default including, but not limited to: failure to pay principal or interest when due (subject to grace period); any representation or warranty proving to have been materially incorrect when made or confirmed; failure to perform or observe covenants set forth in the Credit Agreement; and bankruptcy and insolvency defaults.

Board Agreement

On February 15, 2008, the Company entered into an Agreement (the "Board Agreement") among the Company, BAC and Robert Stuckelman, John Minnick, John Romm, M.D., and Stuart Silverman, M.D., each a member of the board of directors of the Company (each of Messrs. Stuckelman, Minnick, Romm and Silverman being collectively referred to as the "Resigning Board Members"). Pursuant to the terms of the Board Agreement, BAC and the Company terminated certain agreements dated May 17, 2007 relating to the rights and obligations of BAC and the Company regarding voting and otherwise supporting the nominations of members of the Board of Directors of the Company. In addition, the Board Agreement required that each of the Resigning Board Members submit his resignation as a board member of the Company concurrently with the execution thereof, and each of BAC and the Resigning Board Members executed and delivered a mutual general release of claims against each other. The Board Agreement was a condition of BAC's willingness to enter into the Credit Agreement.

On December 16, 2008, the Company entered into an amended revolving line of credit agreement (the Amended Credit Agreement ) between the Company, as Borrower, and Boston Avenue Capital, LLC, an Oklahoma limited liability company, as Lender (the Lender or BAC ). The Amended Credit Agreement amends the original credit agreement entered into between Borrower and Lender dated February 15, 2008 (the Original Credit Agreement ).

The Amended Credit Agreement provides a credit facility in an aggregate principal amount of up to $4 million. Advances under the revolving line of credit shall bear interest at the current three-month London Interbank Offered Rate (LIBOR), payable quarterly in arrears for the prior fiscal quarter on the fifth business day of each January, April, July and October commencing after the first advance. The Amended Credit Agreement provides that unused amounts up to the total commitment shall bear interest at a rate of one percent (1%) per annum, compounded annually on the first business day of each calendar year. BAC is not required to maintain a third party letter of credit in support of the Amended Credit Agreement. Borrower may, at any time, reduce the total amount of the Letter of Credit (as hereafter

provided) by written notice to the Lender and the issuer thereof and no Commitment Interest or other fee or charge shall be due or payable by Borrower in respect of the amount by which the Letter of Credit is so reduced. The Amended Credit Agreement matures on December 31, 2010.

The Amended Credit Agreement terminates the 16,000,000 warrants (the Original Warrants ) issued to BAC as consideration for the Original Credit Agreement. The Original Warrants were granted i) at a variable price based on the trading of the stock price and ii) regardless of whether an advance was made under the Original Credit Agreement. Under the Amended Credit Agreement, the Company will issue 16,000,000 warrants (the New Warrants ) to BAC for a purchase price of $5,000 only if, and after, an advance of funds under the Amended Credit Agreement occurs. The strike price of the New Warrants is fixed at two dollars ($2.00) each. The New Warrants

may only be issued upon shareholder approval, which the Company must use its best efforts to obtain before the second anniversary of any advance.

The Amended Credit Agreement contains customary representations and warranties of the Company. Availability under the new revolving line of credit is subject to certain conditions, including (i) that the existing board member of the Company and other directors approved by the Lender comprise all of the directors of the Company, (ii) that the members of the board of directors of the Company unanimously approve any advance, (iii) that there not be any undisclosed material liabilities at the time of an advance, and (iv) that the Lender shall have consented (in its sole discretion) in the event that an advance is requested and, at the time of the request for the advance, the Company or any of its officers, directors, employees, shareholders or affiliates is a party to any pending legal proceedings related to the Company or its affiliates.

Advances under the Amended Credit Agreement may be prepaid at any time in whole or in part without premium or penalty. The Amended Credit Agreement also includes certain customary events of default including, but not limited to: Failure to pay principal or interest when due (subject to grace period); any representation or warranty proving to have been materially incorrect when made or confirmed; failure to perform or observe covenants set for the in the Amended Credits Agreement; and bankruptcy and insolvency defaults.

On November 4, 2008, the Board of Directors of the Company approved the Amended Credit Agreement, with Mr. Chuck Gillman, the manager of BAC, abstaining.

As of December 31, 2008, there was no draw made against the line of credit.

**MATERIAL TRENDS AND UNCERTAINTIES**

The marketplace acceptance of peripheral densitometry equipment is still limited, and subject to complex scientific, clinical, reimbursement and policy-making factors which are constantly evolving. It is difficult to predict if any of these factors will create material barriers to our ability to expand the OsteoGram or OsteoCare business. Additionally, these factors are different in various foreign markets. The overall business is also competitive and a number of competitive technologies are emerging that may hinder the acceptance of our product in the marketplace. We are investing heavily to help our channel partners develop the expertise to position and sell our products effectively, however, we have not yet seen material results from that effort and there are no guarantees that we will.

Our ECG business is very competitive and we rely significantly on certain contracts with individual state governments. A number of such contracts are coming due for renewals and we are engaged in a competitive bidding process to win further contracts with those state governments. The loss of any one of these contracts could have a material adverse effect on our revenue. Additionally, it is possible that competitive pressures may force us to lower our prices, which could adversely affect our overall revenues as well as our gross profits. Additionally many of our customers have responded to the current financial and economic crisis by reducing their volume of use to high-risk patients. If this trend should continue we might experience a downturn of our volume of business, which might not be offset by an increase of revenue from other sources.

We are also potentially vulnerable by fiscal and budget crisis on the part of the States that are our principal customers. The Company receives significant revenues form the States of California, Illinois, New York and Florida and any significant budget problems in those states could adversely affect us.

If our revenues should be impacted materially by some of these negative trends, we might have to draw on our credit line or seek equity capital to meet short-term liquidity needs. Both of those events might be dilutive to our shareholders. Additionally we might not meet all the conditions and criteria to affect a drawdown on the credit facility or to be able to secure suitable equity funding from an investor. In such an event, the Company might be forced to significantly reduce its operations or abandon some or all of its activities.

**OFF-BALANCE SHEET ARRANGEMENTS**

None.

**Item 3.**

**Quantitative and Qualitative Disclosures About Market Risk**

As of December 31, 2008, our financial instruments are not exposed to significant market risk due to foreign currency exchange risk or commodity price risk. However, we are exposed to market risk related to changes in market prices of our marketable securities. The carrying values of our marketable securities are based on quoted

market prices. Market prices are subject to fluctuation and, consequently, the amount realized on a subsequent sale may differ significantly from the reported market value. Fluctuation in the market price of a security may result from perceived changes in the underlying economic characteristics of the issuer, the relative price of alternative investments and general market conditions. Furthermore, amounts realized in the sale of a particular security may be affected by the relative quantity of the security being sold.

As of December 31, 2008, we had approximately $230,000 of marketable securities, cash and cash equivalents, of which $138,000 was invested in mutual funds.

In response to the market volatility, on August 17, 2007, we implemented a new investment policy, which provides that our cash and marketable securities will, to the extent practicable, be invested in U.S. treasury securities or mutual funds consisting solely of U.S. treasury securities. In addition, at meetings held on August 17, 2007, our Board of Directors, on recommendation of the Audit Committee and Executive Committee, adopted a resolution to terminate the relationship with our previous investment manager and to transfer our investment portfolio to a new investment manager. This new investment manager will be advising us on the handling of our marketable securities that have unrealized losses in order to minimize further losses and transition to compliance with our new investment policy.

**CRITICAL ACCOUNTING POLICIES**

Our discussion and analysis of our financial condition and results of operations, including the discussion on liquidity and capital resources, are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we re-evaluate our estimates and judgments, particularly those related to the determination of the estimated recoverable amounts of trade accounts receivable, impairment of long-lived assets and deferred tax valuation allowance. We believe the following critical accounting policies require our more significant judgment and estimates used in the preparation of the financial statements.

We maintain an allowance for doubtful accounts for estimated losses that may arise if any of our customers are unable to make required payments. Management specifically analyzes the age of customer balances, historical bad debt experience, customer credit-worthiness, and changes in customer payment terms when making estimates of the uncollectibility of our trade accounts receivable balances. If we determine that the financial conditions of any of our customers deteriorated, whether due to customer specific or general economic issues, increases in the allowance may be made. Accounts receivable are written off when all collection attempts have failed.

We have a significant amount of property, equipment and intangible assets, including patents. In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long Lived Assets, we review our long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable.

Recoverability of long-lived and amortizable intangible assets to be held and used is measured by a comparison of the carrying amount of an asset to the future operating cash flows expected to be generated by the asset. If these assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying value of the assets exceeds their fair value.

ECG sales and services revenue is recognized in accordance with SAB 104 as the following criteria have been met: (1) persuasive evidence of an arrangement exists, (2) the product has been delivered or the services have been rendered, (3) the fee is fixed or determinable, and (4) collectibility of the fee is reasonably assured.

ECG services are comprised of ECG processing, overread, rental and maintenance. ECG processing and over-read revenue is recognized monthly on a per-usage basis after the services are performed. Equipment rental and maintenance revenue is recognized monthly over the terms of the customer's agreement.

ECG product and supplies sales revenue is recognized upon shipment of the products and passage of title to the customer.

OsteoGram software revenue is recognized in accordance with paragraph 8 of SOP 97-2 as the following criteria have been met: (1) persuasive evidence of an arrangement exits, (2) the software has been delivered, (3) the fee is fixed or determinable, and (4) collectibility of the fee is probable. OsteoGram PCS revenue is recognized in

accordance with paragraph 59 of SOP 97-2 as the following criteria have been met: (1) the PCS is part of the initial license (software) fee, (2) the PCS period is for one year, (3) the estimated cost of providing the PCS is immaterial, (4) we do not offer upgrades and enhancements during the PCS arrangement. Our policy is to accrue all estimated costs of providing the PCS services.

Income taxes are accounted for under the asset and liability method. Under this method, to the extent that we believe that the deferred tax asset is not likely to be recovered, a valuation allowance is provided. In making this determination, we consider estimated future taxable income and taxable timing differences expected to reverse in the future. Actual results may differ from those estimates.

**Item 4T.**

**Controls and Procedures**

**EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

Our management evaluated, with the participation of our Chief Executive Officer and our Principal Financial Officer, the effectiveness of design and operation of our disclosure controls and procedures as defined by Rule 13a-15 (e) under the Securities Exchange Act of 1934 (the Exchange Act ) of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Principal Financial Officer have concluded that the design and operation of our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide reasonable assurance that such information is accumulated and communicated to our management. Our disclosure controls and procedures include components of our internal control over financial reporting. Management's assessment of the effectiveness of our internal control over financial reporting is expressed at the level of reasonable assurance that the control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system's objectives will be met.

**CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

There was no change in our internal control over financial reporting during the fiscal quarter ended December 31 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**LIMITATION ON THE EFFECTIVENESS OF CONTROLS**

Our management, including our Chief Executive Officer and Principal Financial Officer, does not expect that our disclosure controls and internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

## PART II - OTHER INFORMATION

**Item 1.**

**Legal Proceedings.**

None.

**Item 2.**

**Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3.**

**Defaults Upon Senior Securities.**

None.

**Item 4.**

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

None.

**Item 5.**

**Other Information.**

None.

**Item 6.**

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

| NUMBER | DESCRIPTION OF EXHIBITS |
|---|---|
| 3.7 | Amendment to Bylaws dated February 15, 2008 (filed as Exhibit 3.7 to the Company s Current Report on Form 8-K, filed on February 19, 2008 and incorporated herein by reference). |
| 4.7 | Amendment No. 2 to Rights Agreement, dated as of February 15, 2008, between the Company and Computershare as successor Rights Agent to U.S. Stock Transfer Corporation (filed as Exhibit 4.7 to the Company s Current Report on Form 8-K, filed on February 19, 2008 and incorporated herein by reference). |
| 10.1 | Amended Revolving Line of Credit Agreement dated December 16, 2008 (filed as Exhibit 10.26 on Form 8-K filed December 17, 2008 and incorporated herein by reference). |
| 10.2 | Letter Agreement dated January 7, 2009 between the Company and Mark Crockett respecting investment banking and financial advisory services. |
| 31.1 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Officers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

**SIGNATURES**

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

**COMPUMED, INC.**

Date: February 17, 2009

By: /s/ MAURIZIO VECCHIONE
Maurizio Vecchione
Interim Chief Executive Officer

Date: February 17, 2009

By: /s/ PHUONG DANG
Phuong Dang
Secretary, Controller and Principal Financial Officer