ENPATH MEDICAL INC
Form 10-Q
November 13, 2006

# 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 September 30, 2006

**Or**

**o** TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

**Commission File Number 0-19467**

# Enpath Medical, Inc.

(Exact name of registrant as specified in its charter)

| **Minnesota** | **41-1533300** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |

**15301 Highway 55 West, Plymouth, MN 55447**

(Address of principal executive office, including zip code)

**(763) 559-2613**

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes **x** No **o**

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

Large Accelerated Filer **o** Accelerated Filer **o** Non-Accelerated Filer **x**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes **o** No **x**

The number of shares of Registrant s common stock outstanding on November 8, 2006 was 6,260,334.

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**PART I FINANCIAL INFORMATION**



**PART II OTHER INFORMATION**

**Item 1. Condensed Financial Statements**

**Balance Sheets**

| | 09/30/06 Unaudited | 12/31/05 |
|---|---|---|
| **ASSETS** | | |
| **Current assets:** | | |
| Cash and cash equivalents | $ 1,503,703 | $ |
| Accounts receivable, less allowance for doubtful accounts of $56,000 and $57,000, respectively | 4,463,512 | 3,862,199 |
| Inventories, less allowance for slow-moving inventory of $243,000 and $258,000, respectively | 6,199,880 | 4,539,265 |
| Prepaid expenses and other assets | 187,659 | 164,790 |
| Income taxes receivable | | 69,887 |
| Notes receivable | 90,000 | 90,000 |
| Deferred income taxes | 137,100 | 234,315 |
| **Total current assets** | **12,581,854** | **8,960,456** |
| | | |
| **Property and equipment:** | | |
| Equipment | 8,083,013 | 6,978,553 |
| Office furniture, fixtures and computers | 1,915,789 | 1,870,422 |
| Leasehold improvements | 1,850,706 | 1,708,254 |
| | **11,849,508** | **10,557,229** |
| Less accumulated depreciation and amortization | (7,193,662 ) | (5,871,108 ) |
| **Net property and equipment** | **4,655,846** | **4,686,121** |
| | | |
| **Other non-current assets:** | | |
| Goodwill | 9,487,975 | 9,487,975 |
| Intangible assets with finite lives, net | 4,843,527 | 5,322,666 |
| Notes receivable | | 45,000 |
| Deferred income taxes | 1,399,675 | 1,548,740 |
| **Total other non-current assets** | **15,731,177** | **16,404,381** |
| | | |
| **TOTAL ASSETS** | **$ 32,968,877** | **$ 30,050,958** |
| | | |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| **Current liabilities:** | | |
| Current maturities of note payable to bank | $ 1,000,000 | $ 1,000,000 |
| Current installments of capital lease obligations | | 4,714 |
| Bank line of credit | | |
| Accounts payable | 1,397,725 | 928,807 |
| Accrued compensation | 1,244,448 | 713,903 |
| Other accruals | 418,641 | 263,259 |
| Income taxes payable | 187,457 | |
| Deferred revenue | 56,250 | 56,250 |
| **Total current liabilities** | **4,304,521** | **2,966,933** |
| | | |
| **Long-term liabilities:** | | |
| Notes payable to bank, less current maturities | 883,310 | 1,833,316 |
| Deferred revenue | 182,812 | 225,000 |
| **Total long-term liabilities** | **1,066,122** | **2,058,316** |
| | | |
| **Total liabilities** | **5,370,643** | **5,025,249** |
| | | |
| **Shareholders equity:** | | |
| Preferred stock-undesignated, authorized 1,000,000 shares | | |

| | | |
|---|---|---|
| Common stock-$.01 par value, authorized 20,000,000 shares; issued and outstanding 6,256,869 and 6,035,380 shares, respectively | 62,569 | 60,353 |
| Additional paid-in capital | 23,386,677 | 22,200,269 |
| Retained earnings | 4,148,988 | 2,765,087 |
| **Total shareholders equity** | **27,598,234** | **25,025,709** |
| | | |
| **TOTAL LIABILITIES AND SHAREHOLDERS EQUITY** | **$ 32,968,877** | **$ 30,050,958** |

*See accompanying notes to condensed financial statements*

**Income Statements (Unaudited)**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | 09/30/06 | 09/30/05 | 09/30/06 | 09/30/05 |
| Net sales | $ 9,324,348 | $ 7,669,486 | $ 28,277,149 | $ 21,479,897 |
| Cost of sales | 6,223,182 | 4,846,479 | 17,488,666 | 13,510,228 |
| **Gross profit** | **3,101,166** | **2,823,007** | **10,788,483** | **7,969,669** |
| | | | | |
| **Operating expenses:** | | | | |
| Research and development | 1,211,262 | 1,207,206 | 4,153,593 | 4,177,345 |
| Selling, general and administrative | 1,600,881 | 1,169,760 | 4,695,223 | 4,092,471 |
| **Total operating expenses** | **2,812,143** | **2,376,966** | **8,848,816** | **8,269,816** |
| | | | | |
| **Operating income (loss)** | **289,023** | **446,041** | **1,939,667** | **(300,147)** |
| | | | | |
| **Other income (expense):** | | | | |
| Interest expense | (44,468) | (73,272) | (143,206) | (197,425) |
| Interest income | 4,417 | | 8,268 | |
| Other | (1,802) | (7,480) | 622 | (21,433) |
| **Total other income (expense)** | **(41,853)** | **(80,752)** | **(134,316)** | **(218,858)** |
| | | | | |
| **Income (loss) before income taxes** | **247,170** | **365,289** | **1,805,351** | **(519,005)** |
| Income tax (expense) benefit | 123,913 | (127,851) | (421,450) | 181,652 |
| **Net income (loss)** | **$ 371,083** | **$ 237,438** | **$ 1,383,901** | **$ (337,353)** |
| | | | | |
| **Net income (loss) per common share:** | | | | |
| Basic | $ 0.06 | $ 0.04 | $ 0.22 | $ (0.06) |
| Diluted | $ 0.06 | $ 0.04 | $ 0.22 | $ (0.06) |
| | | | | |
| **Weighted average common and common equivalent shares outstanding** | | | | |
| Basic | 6,239,599 | 5,973,107 | 6,178,799 | 5,940,639 |
| Diluted | 6,342,348 | 6,079,641 | 6,302,606 | 5,940,639 |

*See accompanying notes to condensed financial statements*

**Statement of Shareholders Equity (Unaudited)**

| | Common Stock Shares | Amount | Additional Paid-In Capital | Retained Earnings | Total |
|---|---|---|---|---|---|
| **Balances at December 31, 2005** | **6,035,380** | **$ 60,353** | **$ 22,200,269** | **$ 2,765,087** | **$ 25,025,709** |
| Options exercised | 188,364 | 1,884 | 776,921 | | 778,805 |
| Restricted stock grants | 33,125 | 332 | 21,983 | | 22,315 |
| Stock-based compensation | | | 283,974 | | 283,974 |
| Tax benefit from options exercised | | | 103,530 | | 103,530 |
| | | | | 1,383,901 | 1,383,901 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Net income for the nine months ended September 30, 2006 | | | | | | | | |
| **Balances at September 30, 2006** | **6,256,869** | **$** | **62,569** | **$** | **23,386,677** | **$** | **4,148,988** | **$** | **27,598,234** |

*See accompanying notes to condensed financial statements*

**Statements of Cash Flows (Unaudited)**

| | Nine Months Ended 09/30/06 | 09/30/05 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income (loss) | $ 1,383,901 | $ (337,353) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,975,975 | 1,837,992 |
| Non-cash consulting services | | 6,096 |
| Non-cash stock-based compensation | 306,289 | |
| Deferred income taxes | 246,280 | |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (601,313) | (29,545) |
| Inventories | (1,660,615) | (1,274) |
| Prepaid expenses and other assets | (22,869) | 82,240 |
| Income taxes receivable | 69,887 | 106,278 |
| Accounts payable | 468,918 | 161,220 |
| Accrued expenses | 685,927 | 80,063 |
| Income taxes payable | 187,457 | |
| Deferred revenue | (42,188) | 150,000 |
| **Net cash provided by operating activities** | **2,997,648** | **2,055,717** |
| | | |
| **Cash flows from investing activities:** | | |
| Purchase of property and equipment | (1,292,278) | (993,289) |
| Additions to intangible assets | (174,282) | (263,968) |
| Additional cash paid for acquisition | | (97,771) |
| Proceeds from notes receivable | 45,000 | |
| **Net cash used in investing activities** | **(1,421,559)** | **(1,355,028)** |
| | | |
| **Cash flows from financing activities:** | | |
| Principal payments on capital lease obligations | (4,714) | (54,648) |
| Principal payments on long-term debt | (950,006) | (750,006) |
| Borrowings on line of credit | | 218,348 |
| Proceeds from exercise of options and warrants | 778,805 | 132,838 |
| Tax benefit from options exercised | 103,530 | |
| **Net cash used in financing activities** | **(72,385)** | **(453,468)** |
| | | |
| **Net increase in cash and cash equivalents** | **1,503,703** | **247,221** |
| | | |
| **Cash and cash equivalents, beginning of period** | | **362,625** |
| | | |
| **Cash and cash equivalents, end of period** | **$ 1,503,703** | **$ 609,846** |
| | | |
| **Supplemental disclosure of cash flow information:** | | |
| Cash paid during the period for interest | $ 143,206 | $ 73,272 |
| Cash paid (refunds received) during the period for income taxes | $ (185,704) | $ (287,929) |
| | | |
| **Supplemental schedule of noncash investing activity:** | | |
| Common stock issued in payment of contingent purchase price | $ | $ 391,085 |
| Reduction of goodwill due to adjustment to final contingent payment | $ | $ 120,000 |

*See accompanying notes to condensed financial statements*

**Notes to Condensed Financial Statements**
**Nine Months Ended September 30, 2006**
**(Unaudited)**

**1. Basis of presentation**

The financial statements included in this Form 10-Q have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to these rules and regulations, although management believes the disclosures are adequate to make the information presented not misleading. These statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

The financial statements presented herein as of September 30, 2006 and for the three and nine month periods ended September 30, 2006 and 2005 reflect, in the opinion of management, all material adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial position, results of operations and cash flows for these interim periods.

**2. Inventories**

Inventories are stated at the lower of cost, determined on a first-in, first-out (FIFO) basis, or market. Inventories consist of the following:

| | September 30, 2006 | December 31, 2005 |
|---|---|---|
| Purchased parts and subassemblies | $ 4,161,328 | $ 3,176,993 |
| Work in process | 1,200,781 | 850,124 |
| Finished goods | 837,771 | 512,148 |
| **Total Inventories** | **$ 6,199,880** | **$ 4,539,265** |

**3. Finite Life Intangible Assets**

Finite life intangible assets at September 30, 2006 and December 31, 2005 are as follows:

| | Estimated Lives (Years) | September 30, 2006 Gross Carrying Amount | Accumulated Amortization | Net Value |
|---|---|---|---|---|
| Licensed technology | 2 | $ 115,000 | $ 115,000 | $ |
| Core technology | 12 | 2,650,000 | 644,105 | 2,005,895 |
| Developed technology | 8 | 1,500,000 | 546,875 | 953,125 |
| Customer relationships | 6 | 615,000 | 298,970 | 316,030 |
| Patents and inventions | 5 to 9 | 1,821,989 | 795,457 | 1,026,532 |
| Trade name | 30 | 545,000 | 52,990 | 492,010 |
| Other | 5 to 10 | 99,832 | 49,897 | 49,935 |
| **Totals** | | **$ 7,346,821** | **$ 2,503,294** | **$ 4,843,527** |

| | Estimated Lives (Years) | December 31, 2005 Gross Carrying Amount | Accumulated Amortization | Net Value |
|---|---|---|---|---|
| Licensed technology | 2 | $ 115,000 | $ 86,250 | $ 28,750 |
| Core technology | 12 | 2,650,000 | 478,478 | 2,171,522 |
| Developed technology | 8 | 1,500,000 | 406,250 | 1,093,750 |
| Customer relationships | 6 | 615,000 | 222,092 | 392,908 |

| | | | | |
|---|---|---|---|---|
| Patents and inventions | 5 to 9 | 1,650,968 | 581,020 | 1,069,948 |
| Trade name | 30 | 545,000 | 39,364 | 505,636 |
| Other | 5 to 10 | 96,571 | 36,419 | 60,152 |
| **Totals** | | **$ 7,172,539** | **$ 1,849,873** | **$ 5,322,666** |

**Amortization expense related to these assets is as follows:**

| | |
|---|---|
| Quarter ended September 30, 2006 | $211,508 |
| Quarter ended September 30, 2005 | $213,843 |
| Nine months ended September 30, 2006 | $653,421 |
| Nine months ended September 30, 2005 | $628,305 |

**Amortization expense on these assets over the next five fiscal years is estimated to be as follows:**

| Year | Amount |
|---|---|
| Remainder of 2006 | $212,000 |
| 2007 | $848,000 |
| 2008 | $845,000 |
| 2009 | $726,000 |
| 2010 | $495,000 |

**4. Financing arrangements**

In August 2006, we entered into a second financing arrangement with our principal bank that included a seven-year term loan of up to $4 million which will be used to finance the build-out of our new facility. The borrowings will be secured by substantially all of our assets and the new leasehold improvements.

Payments on the new term loan will consist of interest payments only on the amount borrowed at LIBOR plus 2.5% until the end of February 2007. Beginning March 2007, the term loan amount will become fixed based on the amount borrowed and payments will commence in March 2007 at a fixed rate plus interest at LIBOR plus 2.5% for the remaining term of the loan. As of September 30, 2006, we had no outstanding borrowings on this term loan.

**5. Net Income (Loss) Per Common Share**

Basic per-share amounts are computed, generally, by dividing net income (loss) by the weighted-average number of common shares outstanding. Diluted per-share amounts assume the conversion, exercise, or issuance of all potential common stock instruments unless their effect is not dilutive which would be the case when the Company is in a loss situation.

**6. Income Taxes**

During the third quarter of 2006, we recognized a benefit in income tax expense of approximately $210,000 related to the reversal of previously recorded tax reserves that we determined were no longer needed. Due to changes in facts and circumstances, we no longer believe these tax reserves to be probable and have therefore reversed the balances. As a result, our effective tax rate for the nine months ended September 30, 2006 was approximately 23% compared to 35% for the same period in 2005.

**7. Stock-Based Compensation**

We currently have two active stock-based compensations plans under which there are awards still available for grant: The 1999 Incentive Stock Option Plan and the 1999 Non-Employee Director and Medical Advisory Board Stock Option Plan. We have two additional plans that had stock option activity during 2006, including the exercise of stock options and forfeitures.

Effective January 1, 2006, the Company adopted Financial Accounting Standards Board ( FASB ) Statement No. 123 (revised 2004), Share-Based Payment (FAS 123R) utilizing the modified prospective approach. Prior to the adoption of FAS 123R, we accounted for stock option grants in

accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees (the intrinsic value method), and accordingly, recognized no compensation expense for stock option grants.

Under the modified prospective approach, FAS 123R applies to new awards and to awards that were outstanding on January 1, 2006 that are subsequently modified, repurchased or cancelled. Under the modified prospective approach, compensation cost recognized in the three and nine month periods ended September 30, 2006 includes compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of FAS 123, and compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of FAS 123R. Prior periods were not restated to reflect the impact of adopting the new standard. We incurred a total of $140,640 and

$306,289 in compensation expense for the three and nine month periods ended September 30, 2006 as a result of our adoption of FAS 123R.

As a result of adopting FAS 123R on January 1, 2006, our income before taxes, net income and basic and diluted earnings per share for the three and nine months ended September 30, 2006 were lower than if we had continued to account for stock-based compensation under APB Opinion No. 25 for our stock option grants. The As Reported column presents our results in accordance with generally accepted accounting principles. The Pro forma Under APB 25 column shows what our 2006 results would have been had we continued to report our results in accordance with APB 25, that is without the $140,640 and $306,289 of compensation expenses. We believe this presentation facilitates a quarter-to-quarter understanding of the effect of 123R on our 2006 results (see chart below).

| | **Three Months Ended September 30, 2006** | | **Nine Months Ended September 30, 2006** | |
|---|---|---|---|---|
| | **As Reported** | **Pro Forma Under APB 25** | **As Reported** | **Pro Forma Under APB 25** |
| Income before taxes | 247,170 | 247,170 | 1,805,351 | 1,805,351 |
| Add back compensation expense | 0 | 140,640 | 0 | 306,289 |
| **Adjusted income before taxes** | **247,170** | **387,810** | **1,805,351** | **2,111,640** |
| Income tax (expense) benefit | 123,913 | 54,876 | (421,450) | (492,012) |
| **Net income** | **371,083** | **442,686** | **1,383,901** | **1,619,628** |
| | | | | |
| **Net income (loss) per common share** | | | | |
| Basic | $ 0.06 | $ 0.07 | $ 0.22 | $ 0.26 |
| Diluted | $ 0.06 | $ 0.07 | $ 0.22 | $ 0.26 |
| | | | | |
| **Weighted average common and common equivalent shares outstanding** | | | | |
| Basic | 6,239,599 | 6,239,599 | 6,178,799 | 6,178,799 |
| Diluted | 6,342,348 | 6,342,348 | 6,302,606 | 6,302,606 |

We receive a tax deduction for certain employee stock option exercises during the period in which options are exercised, generally for the excess of the prices at which the options are exercised or sold over the exercise prices of the options. Prior to the adoption of FAS 123R, we reported all tax benefits resulting from the exercise of stock options as operating cash flows in our condensed consolidated statements of cash flows. In accordance with FAS 123R, for the nine months ended September 30, 2006, we changed our condensed statements of cash flows presentation to report the tax benefits from the exercise of stock options as financing cash flows. Proceeds from the exercise of stock options were $778,805 for the nine month periods ended September 30, 2006, while the actual income tax benefit realized from stock option exercises was $103,530 for the nine months ended September 30, 2006 and was reported as financing cash flows rather than operating cash flows.

The following table illustrates the effect on operating results and per share information had the Company accounted for stock-based compensation in accordance with FAS 123R for the three and nine months ended September 30, 2005. We believe this presentation facilitates a quarter-to-quarter understanding of the effect of 123R on our 2006 results.

| | **Three Months Ended September 30, 2005** | **Nine Months Ended September 30, 2005** |
|---|---|---|
| Net income (loss) as reported | 237,438 | (337,353) |
| Deduct: Total stock-based employee compensation (expense determined under the fair value based method for all awards) *** | (51,132) | (1,816,986) |
| **Pro forma net income (loss)** | **186,306** | **(2,154,339)** |
| | | |
| **Net loss per share:** | | |
| Basic net income (loss) per share-as reported | $ 0.04 | $ (0.06) |
| Basic net income (loss) per share-pro forma | $ 0.03 | $ (0.36) |
| Diluted net income (loss) per share-as reported | $ 0.04 | $ (0.06) |
| Diluted net income (loss) per share-pro forma | $ 0.03 | $ (0.36) |

| | | |
|---|---|---|
| **Weighted average common and common equivalent shares outstanding** | | |
| Basic | 5,973,107 | 5,940,639 |
| Diluted | 6,079,641 | 5,940,639 |

*** Large amount for the nine month period is due to accelerated vesting of all outstanding incentive options on April 28, 2005 (see Critical Accounting Policies and Estimates - stock based compensation and accelerated vesting section of this Form 10-Q for further explanation).

**Stock Options**

We use the Black-Scholes option pricing model to estimate the fair value of stock-based awards with the following weighted-average assumptions for the indicated periods.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Expected dividend yield | 0 % | 0 % | 0 % | 0 % |
| Expected stock price volatility | 58.6 % | 65.8 % | 72.0 % | 47.7 % |
| Risk-free interest rate | 5.1 % | 4.0 % | 4.5 % | 3.8 % |
| Expected life of options (years) | 6 | 6 | 6 | 6 |
| **Weighted average fair value of options granted** | **$ 6.54** | **$ 4.27** | **$ 6.29** | **$ 4.16** |

The assumptions above are based on multiple factors, including historical exercise patterns of employees in relatively homogenous groups with respect to exercise and post-vesting employment termination behaviors, expected future exercising patterns for these same homogeneous groups and the historical volatility of our stock price.

At September 30, 2006, there was approximately $1,084,000 of unrecognized compensation cost related to share-based payments that we expect to recognize over a weighted-average period of 2 years.

The following table represents stock option activity for the nine months ended September 30, 2006:

| | # Shares | Weighted Avg Exercise Price | Weighted Avg Remaining Contract Life |
|---|---|---|---|
| Options outstanding at beginning of period | 828,407 | $ 8.55 | |
| Options granted | 228,000 | 10.16 | |
| Options exercised | (188,364) | 4.13 | |
| Options surrendered | (74,650) | 11.28 | |
| **Options outstanding at end of period** | **793,393** | **$ 9.81** | **3.94** |
| | | | |
| **Options exercisable at end of period** | **568,458** | **$ 9.71** | **3.27** |

At September 30, 2006, shares available under existing plans for future stock option grants or restricted stock grants to employees were 247,825 and shares available under existing plans for future stock option grants to directors were 176,500.

**Restricted Stock**

Our 1999 Incentive Stock Option plan and 1999 Non-Employee Director and Medical Advisory Board Stock Option plan allow for the issuance of restricted stock awards that may not be sold or otherwise transferred until certain restrictions have lapsed. The unearned stock-based compensation related to these awards is being amortized to compensation expense over the period the restrictions lapse (generally five years). The share based expense for these awards was determined based on the market price of our stock on the date of grant applied to the total number of shares that were anticipated to fully vest and then amortized over the vesting period. As of September 30, 2006, we have unearned stock-based compensation of approximately $211,000 associated with these awards.

The following table represents the compensation expense that was included in general and administrative expenses and cost of revenues in the accompanying condensed statements of operations related to these restricted stock grants for the periods indicated below:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Stock-based compensation expense | $ 10,339 | $ | $ 22,314 | $ |

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The following table presents the restricted shares that were granted and outstanding as of the nine months ended September 30, 2006 and the twelve months ended December 31, 2005:

| Restricted Stock | September 30, 2006 | December 31, 2005 |
|---|---|---|
| Beginning shares outstanding | 4,215 | 0 |
| Granted during and as of the period ended | 31,330 | 4,215 |
| Exercised during and as of the period ended | 0 | 0 |
| Forfeited during and as of the period ended | (2,420 | ) 0 |
| **Ending Shares Outstanding** | **33,125** | **4,215** |

**8. Recently Issued Accounting Pronouncements**

- FIN 47 Accounting for Condition Asset Retirement Obligations. Requires companies to estimate the fair value of exit costs, usually required by contractual lease agreement. The Company was required to adopt FIN 47 in the current fiscal year and it had no impact on the financial statements.

- FIN 48 Accounting for Uncertainty in Income Taxes. Requires companies to assess the probability of tax positions and record only those that are more likely than not to be upheld upon IRS examination. If companies take a position in their tax return that does not meet the more likely than not threshold, they must book a liability for the amount in excess of the maximum amount to be realized. This liability is outside of deferred taxes and related valuation reserves. FIN 48 will be effective for the Company as of January 1, 2007.

**9. Contingencies**

On June 12, 2006, Enpath was named as defendant in a patent infringement action filed by Pressure Products Medical Supplies, Inc, and venued in the United States District Court in the Eastern District of Texas. On October 2, 2006, Enpath was officially served. Enpath has filed an answer denying liability and has filed counterclaims against the plaintiff alleging anti-trust violations and patent misuse.

The product identified as allegedly infringing the plaintiff s patent is the Company s FlowGuard valved introducer, which has been on the market for more than three years. Revenues from products sold that include the FlowGuard valved introducer were approximately 5% of total revenue for the nine-month periods ended September 30, 2006 and 2005. Enpath believes that the plaintiff s claims are without merit and intends to pursue its defenses vigorously.

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

The following discussion and analysis provides information that management believes is relevant to an assessment and understanding of the results of operations and financial condition. This discussion should be read in conjunction with the accompanying financial statements and footnotes.

**Overview**

We are a medical products company engaged in:

- designing, developing, manufacturing and marketing of percutaneous vessel introducers, implantable stimulation leads, steerable catheter delivery products and accessories for the cardiac rhythm management ( CRM ), neuromodulation and interventional radiology markets, and;

- manufacturing of medical devices and components for other medical product companies on a contract basis.

We manufacture and market a family of percutaneous venous vessel introducers with proprietary features, as well as our own proprietary valved introducer. Vessel introducers enable physicians to create a conduit through which they can insert infusion catheters, implantable ports and pacemaker leads into a blood vessel. These products make up our Introducer product line.

We also develop and manufacture advanced delivery catheters that have a fixed curve or an articulating distal tip section that can be manipulated to enable the health care professional to access parts of the patient s anatomy (such as the left ventricle of the heart) that cannot be reached by traditional introducers. These sophisticated advanced delivery catheters are designed and manufactured to meet the unique needs of each procedure being performed. These products make up our Advanced Delivery Catheter product line.

We also develop and manufacture proprietary and custom designed implantable stimulation leads, adapters and delivery systems for the cardiac and neuromodulation markets. These products make up our Lead Technologies product line.

Through December 31, 2005, we combined the sales of the introducer product line and the advanced delivery catheter product line under the heading Delivery Systems because the products were being produced in our Plymouth facility and we

listed the sales of the Lead Technologies product line under the heading Lead Technologies because the products were being produced in our Bloomington facility.

Because each of these three product lines has unique customer requirements, we have assigned general managers to each product line beginning in 2006 in order to provide more product line focus. As part of this process, some of our product sales that were classified as advanced delivery catheters in past periods have been moved into the introducer product line due to product focus and we have adjusted the product line sales categories from 2005 in order to give a better product line comparison going forward. Overall, the business represents one reportable segment: the manufacture and sale of medical devices. We support all sales activities with one sales and marketing department and our general and administrative function has responsibility for the entire Company.

## Results of Operations

**For the three and nine month periods ended September 30, 2006 and 2005**

A summary of our net sales by product line and overall gross profit is shown below:

| Sales | Q3 2006 | Q3 2005 | Change | % Change |
|---|---|---|---|---|
| Introducers | $ 7,002,000 | $ 4,981,000 | $ 2,021,000 | 40.6 % |
| Advanced Delivery Catheters | 222,000 | 388,000 | (166,000) | (42.8)% |
| Lead Technologies | 2,100,000 | 2,300,000 | (200,000) | (8.7)% |
| **Total Sales** | **$ 9,324,000** | **$ 7,669,000** | **$ 1,655,000** | **21.6 %** |
| | | | | |
| **Gross Profit** | **$ 3,101,000** | **$ 2,823,000** | **$ 278,000** | **9.8 %** |
| | | | | |
| **Gross Profit as % of Sales** | **33.3 %** | **36.8 %** | | |

| Sales | YTD 2006 | YTD 2005 | Change | % Change |
|---|---|---|---|---|
| Introducers | $ 19,838,000 | $ 13,962,000 | $ 5,876,000 | 42.1 % |
| Advanced Delivery Catheters | 2,207,000 | 995,000 | 1,212,000 | 121.8 % |
| Lead Technologies | 6,232,000 | 6,523,000 | (291,000) | (4.5)% |
| **Total Sales** | **$ 28,277,000** | **$ 21,480,000** | **$ 6,797,000** | **31.6 %** |
| | | | | |
| **Gross Profit** | **$ 10,788,000** | **$ 7,970,000** | **$ 2,818,000** | **35.4 %** |
| | | | | |
| **Gross Profit as % of Sales** | **38.2 %** | **37.1 %** | | |

Sales of our introducer products increased for both the three and nine month periods ended September 30, 2006 when compared to the same periods in 2005. This increase was primarily due to continued increased sales to both existing and new customers. We expect introducer sales to be lower in the fourth quarter than the third quarter primarily due to several of our customers decreasing orders as they lower their inventories due to year-end activities. We also anticipate that our safety needle sales will drop in the fourth quarter due to many of our customers placing one last stocking order for product in the third quarter as we begin to phase out this product. We are contractually obligated to supply several customers with safety needles and will continue to do so over the next year or so. We anticipate that our introducer product sales will increase when we launch our next generation valved introducer product to the pacing market in the first quarter of 2007.

Sales of our advanced delivery catheter products decreased for the three month period and increased for the nine month periods ending September 30, 2006 when compared to the same periods in 2005. The three month decrease was primarily due to decreased orders from our two primary OEM customers during the quarter after they placed large initial stocking orders in the first half of 2006. The nine month increase was primarily due to a large initial stocking order from one OEM customer in the first quarter of 2006 and continued inventory building orders from both this OEM customer and Bard EP in the second quarter. Both customers have been working on penetrating their respective markets with these products and as we indicated last quarter, our sales of these products going forward will be primarily dependent on the success of these two customers in penetrating their respective markets. To date, activity has been slower than anticipated with our customers but they are still excited about the prospects for these products. We are continuing our development efforts with several other OEM customers on sophisticated delivery catheters that may have utility in the treatment of atrial fibrillation, percutaneous mitral valve repair, carotid stent placement, and a variety of

renal and peripheral interventions. We are also developing

delivery catheters that could be used in conjunction with our stimulation lead products to more efficiently deliver an epicardial or a neurostimulation lead.

Sales of our lead technologies products decreased for both the three and nine month periods ending September 30, 2006 when compared to the same periods in 2005. The decrease was primarily due to decreased accessory and contract manufacturing product sales to several of our OEM customers, as well as decreased engineering service billings during the comparable periods. This decrease was partially off-set by increased sales of our leads and adaptors during the comparable periods. One of our partners is successfully selling our steroid epicardial lead in Europe and we have continued to see increased orders for this product. This partner also commenced selling the FasTac Flex® delivery tool in Europe late in 2005 and plans to evaluate the potential launch of the FasTac Flex in the U.S. We also experienced increased sales of our MyoPore epicardial lead in the United States to several other partners in the first nine months of 2006. We expect to see strong growth in our lead technologies product sales in the fourth quarter primarily due to increased sales of our accessory and contract manufacturing products, as well as continued growth in sales of our leads and adaptor products, including the potential launch in the U.S. of our FasTac Flex delivery tool for improved efficiency when placing the epicardial lead.

Gross profit increased as a dollar amount for both the three and nine month periods ending September 30, 2006 when compared to the same periods in 2005. Gross profit as a percent of sales decreased for the three month period and increased for the nine month period ending September 30, 2006 when compared to the same periods in 2005. Our gross profit percentage was very challenging in the third quarter of 2006, primarily due to lower sales in both our advanced delivery catheter product line and our lead technologies product line which resulted in higher levels of manufacturing overhead not getting applied to inventory. Additionally, we experienced some manufacturing issues with our advanced delivery catheters as we continue to ramp up our capacity which resulted in large amounts of scrap during the quarter. Gross profits for the nine month period were 1% higher than in 2005 primarily due to strong results with our introducer products. Gross profits should improve as sales levels increase and the catheter issues are resolved. We expect our gross margins as a percent of sales to remain in the 37% to 38% range during the fourth quarter of 2006 as we continue to improve manufacturing yields and efficiencies on our advanced delivery catheter product line.

**Shared Expenses for the three and nine month periods ended September 30, 2006 and 2005**

| Shared Expenses | Q3 2006 | Q3 2005 | Change |
|---|---|---|---|
| Research & Development | $ 1,211,000 | $ 1,207,000 | $ 4,000 |
| Sales & Marketing | 313,000 | 376,000 | (63,000) |
| General & Administrative | 1,288,000 | 794,000 | 494,000 |
| Interest Income | (4,000) | 0 | (4,000) |
| Interest Expense | 44,000 | 73,000 | (29,000) |
| Other | 2,000 | 8,000 | (6,000) |
| **Total Shared Expenses, Net** | **$ 2,854,000** | **$ 2,458,000** | **$ 396,000** |
| | | | |
| **Total Sales** | **$ 9,324,000** | **$ 7,669,000** | |

| Percent of Sales | Q3 2006 | Q3 2005 |
|---|---|---|
| Research & Development | 13.0 % | 15.7 % |
| Sales & Marketing | 3.4 % | 4.9 % |
| General & Administrative | 13.8 % | 10.4 % |
| Interest Income | (0.0)% | 0.0 % |
| Interest Expense | 0.5 % | 1.0 % |
| Other | 0.0 % | 0.1 % |

| Shared Expenses | YTD 2006 | YTD 2005 | Change |
|---|---|---|---|
| Research & Development | $ 4,154,000 | $ 4,177,000 | $ (23,000) |
| Sales & Marketing | 1,183,000 | 1,356,000 | (173,000) |
| General & Administrative | 3,512,000 | 2,737,000 | 775,000 |
| Interest Income | (8,000) | 0 | (8,000) |
| Interest Expense | 143,000 | 197,000 | (54,000) |
| Other | (1,000) | 22,000 | (23,000) |
| **Total Shared Expenses, Net** | **$ 8,983,000** | **$ 8,489,000** | **$ 494,000** |
| | | | |
| **Total Sales** | **$ 28,277,000** | **$ 21,480,000** | |

| Percent of Sales | YTD 2006 | YTD 2005 |
|---|---|---|
| Research & Development | 14.7 % | 19.4 % |
| Sales & Marketing | 4.2 % | 6.3 % |
| General & Administrative | 12.4 % | 12.7 % |
| Interest Income | (0.0)% | 0.0 % |
| Interest Expense | 0.5 % | 0.9 % |
| Other | (0.0)% | 0.1 % |

**Research and Development**

Research and development expenses for both the three and nine month periods ended September 30, 2006 were approximately the same when compared to 2005. As a percent of sales, these costs decreased in both the three and nine month periods of 2006 compared to 2005 primarily due to increased sales levels. We are continuing to invest 12-15% of our sales dollars on the development of new products that will bring increased revenues sometime in the future. One of these projects is our next generation product that will improve and simplify the placement of an epicardial lead. We expect research and development expenses to be approximately the same in the fourth quarter as they were in the third quarter.

**Sales and Marketing**

Sales and marketing expenses decreased during the three and nine month periods ended September 30, 2006 compared to 2005 primarily due to lower spending on salaries, consulting, printing and travel. We had some department turnover in late 2005 and again in mid-2006 which decreased these expenses. We expect sales and marketing expenses in the fourth quarter to be approximately the same as the third quarter.

**General and Administrative**

General and administrative expenses increased during the three and nine month periods ended September 30, 2006 compared to 2005. This increase was primarily due to additional personnel costs of $114,000 and $226,000, and stock-based compensation costs of $110,000 and $233,000 due to the adoption of FAS 123R on January 1, 2006, for the three and nine month periods, respectively. We also incurred duplicate rent expense of $110,000 during the third quarter of 2006 on our new facility. We will be incurring duplicate rent expense over the next several quarters until we finalize our move-in, currently anticipated to be in the first quarter of 2007. We are currently in negotiations to sublet our existing facilities; however, if we are not able to successfully sublet our space in full, then we may have to take a charge equal to the remaining rent obligations in the first quarter of 2007. We expect general and administrative expenses in the fourth quarter to be approximately the same as the third quarter. In absolute dollars G&A expenses will increase; however, as we continue to build our revenues, we anticipate that our G&A expenses will decrease as a percentage of revenues.

**Other Expenses**

Interest income increased slightly due to having excess cash to invest in a money market account. Interest expense decreased primarily due to lower balances on the five-year amortizing note payable that was put in place in October 2003 as well as having no outstanding borrowings on the line of credit in 2006. Other income for the year was primarily due to the sale of a piece of equipment and an insurance refund received.

**Income Taxes**

During the third quarter of 2006, we recognized a benefit in income tax expense of approximately $210,000 related to the reversal of previously recorded tax reserves that we determined were no longer needed. Due to changes in facts and circumstances, we no longer believe these tax reserves to be probable and have therefore reversed the balances. As a result, our effective tax rate for the nine months ended September 30, 2006 was approximately 23% compared to 35% for the same period in 2005.

**Net Income**

As a result, we had net income of $371,083 and $1,383,901 or $.06 and $.22 per diluted share for the three and nine months ended September 30, 2006, compared to net income of $237,438 and a net loss of $337,353 or $.04 and ($.06) per diluted share for the three and nine months ended September 30, 2005.

**Liquidity and Capital Resources**

Net cash provided by operating activities for the nine months ended September 30, 2006 was $2,997,648, consisting of net income of $1,383,901, adjusted for non-cash items of depreciation and amortization of $1,975,975, non-cash stock-based compensation of $306,289 and non-cash based deferred income taxes of $246,280, less a net change in operating assets and liabilities of $914,796. Accounts receivable increased during the period primarily due to larger levels of sales when compared to 2005. Receivable days outstanding continue to average 42-46 days. Inventory increased during the period primarily due to our increased sales levels and accounts payable increased during the period commensurate with our increased inventory levels. In anticipation of the upcoming facility consolidation, we plan to build up certain inventory levels so that our partners demand is uninterrupted.

Net cash used in investing activities for the nine months ended September 30, 2006 was $1,421,559. We purchased equipment totaling $1,292,278 and we had additions to intangible assets of $174,282. This was offset by proceeds from notes receivable of $45,000.

Net cash used financing activities for the nine months ended September 30, 2006 was $72,385. We made note payments in the amount of $950,006 and capital lease payments of $4,714. This was offset by cash received from the exercise of options of $778,805 and a tax benefit from options exercised of $103,530.

As a result, our cash and cash equivalents were $1.5 million as of September 30, 2006 compared to $0 at December 31, 2005. Working capital increased from $6.0 million as of December 31, 2005 to $8.3 million as of September 30, 2006.

We currently have three major customers that each account for more than 10% of our sales. The information below includes the percent of sales for the nine months ended September 30, 2006 and 2005 and the related accounts receivable balance on September 30, 2006 and 2005 from these customers.

| | September 30, 2006 | | | | September 30, 2005 | | | |
|---|---|---|---|---|---|---|---|---|
| **Customer** | **% Sales** | | **% A/R** | | **% Sales** | | **% A/R** | |
| A | 30 | % | 32 | % | 27 | % | 36 | % |
| B | 17 | % | 17 | % | 16 | % | 9 | % |
| C | 11 | % | 8 | % | 13 | % | 15 | % |

In October 2003, we entered into a financing arrangement with a bank that included a five-year term loan of $5 million, which was used to finance a portion of the acquisition of BIOMEC Cardiovascular Inc., and a $3 million line of credit. The bank has increased the line of credit limit to $4 million and extended the expiration date to April 30, 2007. The borrowings are secured by substantially all of our assets and also contain financial covenants that must be met on a quarterly basis. The agreement also prohibits the payment of dividends without the consent of the lender.

Payments on the term loan consist of monthly principal payments of $83,334 plus interest at LIBOR plus 2.5%. These payments commenced in November 2003. The line of credit bears interest at LIBOR plus 2.25% with no minimum interest due and expires on April 30, 2007, if not renewed. The availability under the line is subject to borrowing base requirements, and advances are at the discretion of the lender. There were

no borrowings under the line of credit at June 30, 2006, or December 31, 2005, and the entire $4,000,000 is available for use. This commitment is summarized as described below:

| Other Commercial Commitment | Total Amount Committed | Outstanding at 09/30/06 | Date of Expiration |
|---|---|---|---|
| Line of credit | $ 4,000,000 | $ 0 | April 30, 2007 |

In August 2006, we entered into a second financing arrangement with the same bank that included a seven-year term loan of up to $4.0 million which will be used to finance the build-out of our new facility. The borrowings will be secured by substantially all of our assets and the new leasehold improvements. We are consolidating into a single facility and we are expecting to incur cash outlays for leasehold improvements of approximately $3.0 million before the end of the year. We anticipate the total cost of the facility consolidation to total approximately $5.0 million and will be completed during the first quarter of 2007.

Payments on the new term loan will consist of interest payments only on the amount borrowed at LIBOR plus 2.5% until the end of February 2007. Beginning March 2007, the term loan amount will become fixed based on the amount borrowed and payments will commence in March 2007 at a fixed rate plus interest at LIBOR plus 2.5% for the remaining term of the loan. As of September 30, 2006, we had no outstanding borrowings on this term loan.

A summary of our contractual cash obligations at September 30, 2006 is as follows:

| | Payments due by period | | | | | |
|---|---|---|---|---|---|---|
| **Contractual Obligations** | **Total** | **Remain 2006** | **2007** | **2008** | **2009** | **2010** |
| Long-term debt, including interest | $ 2,227,767 | $ 285,327 | $ 1,092,243 | $ 850,197 | $ | $ |
| Operating leases | $ 2,377,105 | 203,857 | 714,304 | 594,528 | 426,909 | 437,507 |
| **Total contractual cash obligations** | **$ 4,604,872** | **$ 489,184** | **$ 1,806,547** | **$ 1,444,725** | **$ 426,909** | **$ 437,507** |

While we believe that we have sufficient resources with our current cash and credit facility to make payments to meet our long-term debt obligations and fund our planned operations for the remainder of fiscal 2006, there is no assurance that we will not need additional capital in the future. Sources of additional capital may include additional debt financing or the sale of debt or equity securities. There can be no assurance that we will be able to successfully obtain additional capital on favorable terms.

**Critical Accounting Policies and Estimates**

Our significant accounting policies and estimates are summarized in the footnotes to our annual consolidated financial statements. Some of our accounting policies require management to exercise significant judgment in selecting the appropriate assumptions for calculating financial estimates. These judgments are subject to an inherent degree of uncertainty and are based on our historical experience, known trends in our industry, terms of existing contracts and other information from outside sources, as appropriate. Actual results may differ from these estimates under different assumptions and conditions. Certain of the most critical policies that require significant judgment are as follows:

***Revenue Recognition***

We recognize revenue in accordance with Staff Accounting Bulletin 104, *Revenue Recognition in Financial Statements* when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable and collectability is reasonably assured.

***Stock Based Compensation and Accelerated Vesting***

On April 28, 2005, our Board of Directors took action to accelerate vesting of all outstanding employee stock options. As of that date, we had a total of 670,400 employee options outstanding, of which 214,000 were vested and 456,400 were unvested. The Board accelerated the vesting schedule for the 456,400 unvested employee options, of which 439,800 were underwater and 16,600 were in the money. Unvested options that were granted to Board members were not subject to the accelerated vesting.

Summary information related to these options is shown below:

| Employees | Total | Vested | Unvested |
|---|---|---|---|
| Underwater Options | 561,900 | 122,100 | 439,800 |
| In The Money Options | 108,500 | 91,900 | 16,600 |
| **Total Options** | **670,400** | **214,000** | **456,400** |

This action was taken to eliminate approximately $1.3 million in compensation expense that we would otherwise have incurred over four years beginning in 2006, upon the adoption of FAS 123R. We also determined that no compensation

expense needed to be booked for the 16,600 in the money options that were unvested due to the high likelihood of continued employment of the individuals involved, as well as the short remaining period (less than one year) to full vesting.

The Board of Directors has examined our method of compensating employees and Board members through equity awards and has determined that future equity compensation will primarily consist of restricted stock awards to non-officer employees with stock option awards being made only at the officer and Board level. We use the Black-Scholes option pricing model to value stock option awards.

***Allowance for Doubtful Accounts***

We establish estimates of the uncollectability of accounts receivable. Our management analyzes accounts receivable, historical write-offs as bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. We maintain an allowance for doubtful accounts at an amount that we estimate to be sufficient to provide adequate protection against losses resulting from collecting less than full payment on receivables. A considerable amount of judgment is required when assessing the realizability of receivables, including assessing the probability of collection and the current credit-worthiness of each customer. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, an additional provision for doubtful accounts may be required. We have not experienced significant bad debt expense and believe our reserve for doubtful accounts of $56,000 should be adequate for any exposure to loss in our September 30, 2006 accounts receivable.

***Allowance for Excess and Slow-Moving Inventory***

Inventories, which are composed of purchased parts and subassemblies, work in process and finished goods, are valued at the lower of cost or market with cost being determined by the first-in, first-out method. On a periodic basis, we analyze the level of inventory on hand, its cost in relation to market value and estimated customer requirements to determine whether write-downs for excess or slow-moving inventory are required. Actual customer requirements in any future periods are inherently uncertain and thus may differ from estimates. If actual or expected requirements were significantly greater or lower than the established reserves, a reduction or increase to the obsolescence allowance would be recorded in the period in which such a determination was made. We have established a reserve for excess and slow-moving inventories and believe the reserve of $243,000 at September 30, 2006 is adequate.

***Valuation of Goodwill and Long-Lived Assets including Intangible Assets with Finite Lives***

As a matter of policy, we review our major assets for impairment at least annually, and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The test for impairment of finite life assets requires us to make estimates of the fair value of our long-lived assets, primarily based on projected future cash flows using discount rates determined by management to be commensurate with the risk inherent in the current business model or another valuation technique. For indefinite life intangibles, we determine whether the fair value of such assets exceeds the carrying amount of the reporting unit s net assets. If we determine that the carrying value of these assets may not be recoverable, we will reduce the valuation of these assets on our financial statements. Significant intangible assets include the following:

**Goodwill**

The estimate of the fair value of the goodwill that resulted from our acquisition of BCI and the annual impairment test of this asset are significant estimates and require judgment relative to valuation, future cash flows, and market capitalization as well as other matters including the recorded balance of approximately $9.5 million.

**Other Intangibles with Finite Lives**

Other intangibles with finite lives consist primarily of purchased technology, trade name, patents, customer relationships and trademarks (aggregate net balance of $4.84 million at September 30, 2006) and are being amortized on a straight-line method over their estimated useful lives, ranging from 2 to 30 years.

**Recently Issued Accounting Pronouncements**

- FIN 47 Accounting for Condition Asset Retirement Obligations. Requires companies to estimate the fair value of exit costs, usually required by contractual lease agreement. The Company was required to adopt FIN 47 in the current fiscal year and it had no impact on the financial statements.

- FIN 48 Accounting for Uncertainty in Income Taxes. Requires companies to assess the probability of tax positions and record only those that are more likely than not to be upheld upon IRS examination. If companies take a position in their tax return that does not meet the more likely than not threshold, they must book a liability

for the amount in excess of the maximum amount to be realized. This liability is outside of deferred taxes and related valuation reserves. FIN 48 will be effective for the Company as of January 1, 2007.

**Forward Looking Statements**

This Form 10-Q contains forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. Certain important factors could cause results to differ materially from those anticipated by some statements made herein. All forward-looking statements involve risks and uncertainties. A number of factors that could cause results to differ materially are discussed in our Annual Report on Form 10-K for the year ended December 31, 2005, as well as in our quarterly reports on Form 10-Q and Current Reports on Form 8-K. Among the factors that could cause results to differ materially are the following: Enpath s dependence upon a limited number of key customers for its revenue; Enpath s ability to successfully protect its intellectual property against misappropriation or claims of infringement by third parties; the ability of Enpath s customers to successfully develop and market therapies that utilize the Company s advanced delivery systems; Enpath s ability to effectively manufacture its products, specifically steerable catheters, in anticipated required quantities; Enpath s ability to develop or acquire new products to increase its revenues; Enpath s ability to attract and retain key personnel; introduction of competitive products; government regulatory matters; economic conditions; and Enpath s ability to raise capital. All forward-looking statements of Enpath, whether written or oral, and whether made by or on behalf of Enpath, are expressly qualified by these cautionary statements. In addition, Enpath disclaims any obligation to update forward-looking statements to reflect events or circumstances after the date hereof.

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

We are exposed to changes in interest rates primarily as a result of our borrowing activities used to maintain liquidity. Our earnings have not been materially affected by changes in interest rates on our floating interest rate debt because interest rates have remained fairly stable and we have paid down a substantial portion of our debt. Based on our current borrowings and anticipated line of credit requirements in 2006, an increase of 100 basis points in prevailing interest rates would increase our annual interest expense by less than $25,000.

**Item 4. Controls and Procedures**

Management, with the participation of the Company s principal executive officer, John C. Hertig and principal financial officer, Scott P. Youngstrom, has evaluated the effectiveness of the design and operation of the disclosure controls and procedures, as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as of the end of the period covered by this report. Management has concluded that the Company s disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that the Company files under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that the disclosure controls are also effective to ensure that information required to be disclosed in the Company s Exchange Act reports is accumulated and communicated to management, including the principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.

We are currently in the process of reviewing and formalizing our internal controls and procedures for financial reporting in accordance with Securities and Exchange Commission s rules implementing the internal control reporting requirements included in Section 404 of the Sarbanes-Oxley Act of 2002 ( Section 404 ). Changes will be made to our internal controls over financial reporting as a result of these efforts. We are dedicating significant resources, including senior management time and effort, and incurring substantial costs in connection with our ongoing Section 404 assessment. We are currently documenting our internal controls and considering whether any improvements are necessary for maintaining an effective control environment at our Company. The evaluation of our internal controls is being conducted under the direction of our senior management in consultation with an independent third party consulting firm. We plan to finalize documenting our internal controls for the remainder of 2006 and begin testing of these controls in 2007 as we get closer to the Section 404 deadline for our Company which is currently December 31, 2007. We expect to assess our controls and procedures on a regular basis. We will continue to work to improve our controls and procedures and to educate and train our employees on our existing controls and procedures in connection with our efforts to maintain an effective controls infrastructure at our Company.

**PART II - OTHER INFORMATION**

**Item 1 Legal Proceedings**

On June 12, 2006, Enpath was named as defendant in a patent infringement action filed by Pressure Products Medical Supplies, Inc, and venued in the United States District Court in the Eastern District of Texas. On October 2, 2006, Enpath

was officially served. Enpath has filed an answer denying liability and has filed counterclaims against the plaintiff alleging anti-trust violations and patent misuse.

The product identified as allegedly infringing the plaintiff s patent is the Company s FlowGuard valved introducer, which has been on the market for more than three years. Revenues from products sold that include the FlowGuard valved introducer were approximately 5% of total revenue for the nine-month periods ended September 30, 2006 and 2005. Enpath believes that the plaintiff s claims are without merit and intends to pursue its defenses vigorously.

**Item 1A Risk Factors**

Except as set forth below, there have been no material changes from the Risk Factors listed in our Form 10-K for the year ended December 31, 2005.

**We depend on patents and proprietary technology. The lawsuit brought by Pressure Products may affect our future revenues.**

Our success may depend on our ability to obtain patent protection for our products and processes, to preserve our trade secrets and to operate without infringing on the proprietary rights of third parties. We have 20 U.S. and foreign patents issued related to various aspects of vessel introducers, catheters, stimulation leads and implant tools. There can be no assurance that any future patent protection will be granted, that the scope of any patent protection will exclude competitors or that any of our patents will be held valid if subsequently challenged.

We also rely on trade secrets, trademarks, copyrights, know-how, license agreements and contractual provisions to establish and protect our intellectual property rights. These legal means afford us only limited protection and may not adequately protect our rights or remedies to gain or keep any advantages we may have over our competitors.

While we do not believe that any of our products or processes interfere with the rights of others, third parties may nonetheless assert patent infringement claims against us in the future. The validity and breadth of claims covered in medical technology patents involve complex legal and factual questions and therefore may be highly uncertain. Costly litigation may be necessary to enforce patents issued to us, to protect trade secrets or know-how we own, to defend us against claimed infringement of the rights of others or to determine the ownership, scope, or validity of our proprietary rights and the rights of others. Any claim of infringement against us may involve significant liabilities to third parties, could require us to seek licenses from third parties, and could prevent us from manufacturing, selling, or using our products. The occurrence of this litigation or an adverse determination in any of this type of litigation could have a material adverse effect.

As described in Item 1 , Legal Proceedings in this Form 10-Q, on June 12, 2006, we were named as defendant in a patent infringement action filed by Pressure Products Medical Supplies, Inc, and venued in the United States District Court in the Eastern District of Texas. On October 2, 2006, we were officially served. We have filed an answer denying liability and have counterclaims against the plaintiff alleging anti-trust violations and patent misuse. We believe that the claim of infringement is without merit and intend to defend ourselves vigorously in this matter. As discussed above, patent litigation can be expensive and the cost of defending ourselves in this or other actions may have an material impact on future financial results.

The technology of the ViaSeal introducer, our newest valved introducer, is similar to that of the FlowGuard introducer. In response to a request by potential customers, we recently added additional features to the product. The revised ViaSeal introducer will be an improved product, but the implementation of the design modifications resulted in a delay on one version of the product in our 510k submission to the FDA. We have found, however, reluctance on the part of potential customers to commit significant time and resources to purchase and distribute the ViaSeal introducer in light of the lawsuit. Although we believe, and have alleged in our counterclaim, that Pressure Products has violated the antitrust laws and is also liable for patent misuse by its commencement of the lawsuit, our ability to achieve significant market penetration and significant revenues from the ViaSeal product may be more difficult while the lawsuit is pending.

**Item 2 Unregistered Sale of Equity Securities and Use of Proceeds**

None

**Item 3 Defaults Upon Senior Securities**

None

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

None

**Item 5 Other Information**

None

**Item 6(a) Exhibits**

**Exhibit 10.1** Letter Amendment No. 5 dated August 22, 2006, to the Revolving Credit and Term Loan Agreement dated as of October 17, 2003 between the Company and M&I Marshall & Ilsley Bank.(incorporated by reference to Exhibit 10.10.13.4 to the Form 10-K for the year ended December 312, 2004).

**Exhibit 10.2** Term Promissory Note dated August 22, 2006 in favor of M&I Marshall & Ilsley Bank.

**Exhibit 31.1** Certification of principal executive officer pursuant to Section 301 of the Sarbanes-Oxley Act of 2002 (Rules 13a-14 and 15d-14 of the Exchange Act)

**Exhibit 31.2** Certification of principal financial officer pursuant to Section 301 of the Sarbanes-Oxley Act of 2002 (Rules 13a-14 and 15d-14 of the Exchange Act)

**Exhibit 32** Certification pursuant to Section 906 of the Sarbanes Oxley Act of 2002 (18 U.S.C. Section 1350)

**SIGNATURE**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized:

**Enpath Medical, Inc.**

Date: November 10, 2006

By: /s/ John C. Hertig
Chief Executive Officer
By: /s/ Scott P. Youngstrom
Chief Financial Officer