VASOMEDICAL INC
Form 10-Q
January 14, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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 November 30, 2008

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

Commission File Number: 0-18105

VASOMEDICAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	11-2871434
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

180 Linden Ave., Westbury, New York 11590
(Address of principal executive offices)

Registrant's Telephone Number (516) 997-4600

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

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

Large Accelerated Filer [ ] Accelerated Filer [ ] Non-Accelerated Filer [X]

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

Number of Shares Outstanding of Common Stock, $.001 Par Value, at January 12, 2009 - 98,943,004

Vasomedical, Inc. and Subsidiaries

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ITEM 1. FINANCIAL STATEMENTS

Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED BALANCE SHEETS

	November 30, 200
ASSETS	(Unaudited)
CURRENT ASSETS	
Cash and cash equivalents	$ 1,873,
Accounts receivable, net of an allowance for doubtful accounts of $108,953 at November 30, 2008, and $270,183 at May 31, 2008	503,
Inventories, net	1,702,
Other current assets	105,
Total current assets	4,184,
PROPERTY AND EQUIPMENT, net of accumulated depreciation of $2,067,153 at November 30, 2008, and $2,178,566 at May 31, 2008	134,
DEFERRED DISTRIBUTOR COSTS, net of accumulated amortization of $152,663 at November 30, 2008, and $101,775 at May 31, 2008	356,
OTHER ASSETS	189,
	$ 4,865,
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES	

Accounts payable and accrued expenses	$ 514,
Sales tax payable	128,
Deferred revenue	1,067,
Deferred gain on sale of building	53,
Accrued professional fees	76,
Due to related party-current portion	240,
Total current liabilities	2,079,
LONG-TERM LIABILITIES	
Deferred revenue	419,
Accrued rent expense	13,
Deferred gain on sale of building	141,
Due to related party-long-term portion	20,
Total long term liabilities	594,
COMMITMENTS AND CONTINGENCIES	
STOCKHOLDERS' EQUITY	
Preferred stock, $.01 par value; 1,000,000 shares authorized; none issued and outstanding	
Common stock, $.001 par value; 200,000,000 shares authorized; 95,943,004 shares at November 30, 2008, and 93,768,004 at May 31, 2008, issued and outstanding	95,
Additional paid-in capital	48,207,
Accumulated deficit	(46,112,
Total stockholders' equity	2,190,
	$ 4,865,

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

Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

	Six months ended November 30,	
	2008	2007
Revenues		
Equipment sales	$ 1,244,794	$ 1,090,540
Equipment rentals and services	1,225,752	1,637,351
Total revenues	2,470,546	2,727,891
Cost of Sales and Services		
Cost of sales, equipment	891,345	765,054
Cost of equipment rentals and services	542,875	626,323

Total cost of sales and services	1,434,220	1,391,377
Gross profit	1,036,326	1,336,514
Operating Expenses		
Selling, general and administrative	1,629,143	1,200,294
Research and development	279,954	245,002
Total operating expenses	1,909,097	1,445,296
Loss from operations	(872,771)	(108,782)
Other Income (Expenses)		
Interest and financing costs	-	(16,605)
Interest and other income, net	36,535	35,238
Recognition of deferred gain on sale of building	26,623	17,748
Total other income (expenses)	63,158	36,381
Loss before income taxes	(809,613)	(72,401)
Income tax expense, net	(7,602)	(10,447)
Net loss	$ (817,215)	$ (82,848)
Net loss per common share		
- basic	$ (0.01)	$ (0.00)
- diluted	$ (0.01)	$ (0.00)
Weighted average common shares outstanding		
- basic	94,261,960	90,667,355
- diluted	94,261,960	90,667,355

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

Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended November	
	2008	2007
Cash flows provided by (used in) operating activities		
Net loss	$ (817,215)	$ (82,848
Adjustments to reconcile net loss to net cash provided by (used in) operating activities		

Depreciation and amortization	51,179	104,214
Amortization of deferred gain on sale of building	(26,623)	(17,748
Provision for doubtful accounts	-	(27,524
Amortization of deferred distributor costs	50,888	50,888
Expenses paid for distributor agreement	-	(40,490
Stock based compensation	141,357	67,100
Changes in operating assets and liabilities:		
Accounts receivable	214,525	(104,679
Inventories	(145,351)	408,197
Other current assets	(46,333)	(166,148
Accounts payable, accrued expenses and other current liabilities	(387,422)	(163,447
Other liabilities	(65,877)	(157,787
Due to related party	260,000	-
	46,343	(47,424
Net cash used in operating activities	(770,872)	(130,272
Cash flows provided by (used in) investing activities		
Proceeds from the building sale	-	1,400,000
Expenses paid for sale of building	-	(89,143
Purchases of fixed assets	(9,438)	-
Net cash provided by (used in) investing activities	(9,438)	1,310,857
Cash flows provided by (used in) financing activities		
Payments on long term debt and notes payable	-	(851,015
Proceeds from Securities Purchase agreement	-	1,500,000
Expenses paid in relation to Securities Purchase Agreement	-	(124,110
Net cash provided by financing activities	-	524,875
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(780,310)	1,705,460
Cash and cash equivalents - beginning of period	2,653,999	850,288
Cash and cash equivalents - end of period	$1,873,689	$2,555,748
Non-cash investing and financing activities were as follows:		
Inventories transferred to property and equipment, attributable to operating leases, net	$ 95,921	$ (38,531
Common stock issued for distribution agreement	$ -	$ 468,386
Supplemental Disclosures		
Interest paid	$ -	$ 16,605
Income taxes paid	$ 790	$ 2,983

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

Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (unaudited)
November 30, 2008

NOTE A - ORGANIZATION AND PLAN OF OPERATIONS

Vasomedical, Inc. was incorporated in Delaware in July 1987. Unless the context requires otherwise, all references to "we", "our", "us", "Company", "registrant", "Vasomedical" or "management" refer to Vasomedical Inc. and its subsidiaries. Since 1995, we have been primarily engaged in designing, manufacturing, marketing and supporting EECP(R) enhanced external counterpulsation systems based on our unique proprietary technology currently indicated for use in cases of stable or unstable angina (i.e., chest pain), congestive heart failure (CHF), acute myocardial infarction (i.e., heart attack, (MI)) and cardiogenic shock. The EECP(R) therapy is a non-invasive, outpatient treatment of diseases of the cardiovascular system. The therapy serves to increase circulation in areas of the heart with less than adequate blood supply and helps to restore systemic vascular function. The therapy also increases blood flow and oxygen supply to the heart muscle and other organs and decreases the heart's workload and need for oxygen, while also improving function of the endothelium, the lining of blood vessels throughout the body, lessening resistance to blood flow. We provide hospitals, clinics and physician private practices with EECP(R) equipment, treatment guidance, and a staff training and equipment maintenance program designed to provide optimal patient outcomes. EECP(R) is a registered trademark for our enhanced external counterpulsation therapy and systems. For more information, visit www.vasomedical.com.

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

During the last several years, we incurred operating losses. We have attempted to achieve profitability by reducing operating costs and halting the trend of declining revenue, and to reduce cash usage through bringing our cost structure more into alignment with current revenues. By engaging in restructurings during March 2007 and April 2007, the Company has substantially reduced personnel and spending on sales, marketing and development projects. In addition, during the first quarter of fiscal year 2008, we raised additional capital through a private equity financing and by the sale of our facility under a leaseback agreement.

- On June 21, 2007, we entered into a Securities Purchase Agreement with Kerns Manufacturing Corp. (Kerns). Concurrently with our entry into the Securities Purchase Agreement, we also entered into a Distribution Agreement and a Supplier Agreement with Living Data Technology Corporation (Living Data), an affiliate of Kerns.

  We sold to Kerns, pursuant to the Securities Purchase Agreement, 21,428,572 shares of our common stock at $.07 per share for an aggregate of $1,500,000, as well as a five-year warrant to purchase 4,285,714 shares of our common stock at an initial exercise price of $.08 per share (the Warrant). The agreement further provided for the appointment to our Board of Directors of two representatives of Kerns. In furtherance thereof, Jun Ma and Simon Srybnik, Chairman of both Kerns and Living Data, have been appointed members of our Board of Directors. On October 16, 2008 Mr. Jun Ma was appointed President and Chief Executive Officer of the Company. Pursuant to the Distribution Agreement, we have become the exclusive distributor in the United

States of the AngioNew ECP systems manufactured by Living Data. As additional consideration for such agreement, we agreed to issue an additional 6,990,840 shares of our common stock to Living Data. Pursuant to the Supplier Agreement, Living Data is now the exclusive supplier to us of the ECP therapy systems that we market under the registered trademark EECP(R). The Distribution Agreement and the Supplier Agreement each have an initial term extending through May 31, 2012.

Pursuant to a Registration Rights Agreement, we granted to Kerns and Living Data, subject to certain restrictions, "piggyback registration rights" covering the shares sold to Kerns as well as the shares issuable upon exercise of the Warrant and the shares issued to Living Data.

- On August 15, 2007, we sold our facility under a five-year leaseback agreement for $1.4 million. The net proceeds from the sale were approximately $425,000, after payment in full of the two secured notes on our facility, brokers fees, closing costs, and the opening of a certificate of deposit in accordance with the provisions of the new lease.

On November 20, 2008, the Company entered into an Amendment to the Distribution Agreement with Living Data to expand the territory covered in the Distribution Agreement to provide for exclusive distribution rights worldwide. In consideration for these rights, the Company agreed to issue Living Data 3,000,000 restricted shares of its common stock.

NOTE B - STOCK-BASED COMPENSATION

As of June 1, 2006, the Company adopted Statement of Financial Standards No. 123 (revised 2004), Share-Based Payment ("SFAS No. 123 (R)"), which is a revision of SFAS No. 123. SFAS No. 123 (R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends FASB Statement No. 95, Statement of Cash Flows.

Generally, the approach to accounting for share-based payments in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. Pro forma disclosure of the fair value of share-based payments is no longer an alternative to financial statement recognition.

During the six-month period ended November 30, 2008, the Board of Directors did not grant any non-qualified stock options.

During the six-month period ended November 30, 2008, the Company's Board of Directors granted 100,000 shares of common stock to one employee of the Company having a fair market value of $0.08 per share at the time of the respective grant.

Stock-based compensation expense recognized under SFAS 123(R) was $141,357 and $67,100 for the six months endedd November 30, 2008 and 2007, respectively. For purposes of estimating the fair value of each option on the date of grant, the Company utilized the Black-Scholes option-pricing model. The Black-Scholes

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

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

NOTE C - LOSS PER COMMON SHARE

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

	Six months ended November 30,	
	2008	2007
Numerator:		
Net loss	$ (817,215)	$ (82,848)
Denominator:		
Basic - weighted average common shares	94,261,960	90,667,355
Stock options	-	-
Warrants	-	-
Diluted - weighted average common shares	94,261,960	90,667,355
Loss per share - basic	$ (0.01)	$ (0.00)
- diluted	$ (0.01)	$ (0.00)

Options and warrants, in accordance with the following table, were excluded from the computation of diluted loss per share for the six months ended November 30, 2008 and 2007, because the effect of their inclusion would be antidilutive.

	As of November 30,	
	2008	2007
Options	5,134,877	5,886,710
Warrants	6,540,252	6,540,252

11,675,129	12,426,962

NOTE D - INVENTORIES, NET

Inventories, net of reserves consist of the following:

	November 30, 2008	May 31, 2008
Raw materials	$ 872,541	$ 936,035
Work in process	456,874	603,925
Finished goods	372,693	112,718
	$ 1,702,108	$ 1,652,678

At November 30, 2008 and May 31, 2008, the Company had reserves for excess and obsolete inventory of $581,725 and $594,042, respectively.

NOTE E - PROPERTY AND EQUIPMENT

Property and equipment is summarized as follows:

	November 30, 2008	May 31, 2008
Office, laboratory and other equipment	$ 1,238,830	$ 1,368,170
EECP(R) systems under operating leases or under loan for clinical trials	815,320	719,401
Furniture and fixtures	148,165	148,165
	2,202,315	2,235,736
Less: accumulated depreciation	2,067,513	2,178,566
Property and equipment - net	$ 134,802	$ 57,170

Depreciation expense amounted to $9,957 and $30,504 for the three-month period ended November 30, 2008 and 2007, respectively. For the six-month period ended November 30, 2008 and 2007, depreciation expense was $27,729 and $89,238 respectively.

NOTE F - DEFERRED REVENUE

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

	Six Months Ended November 30,

	2008	2007
Deferred revenue at the beginning of the period	$ 1,618,053	$ 1,756,351
Additions:		
Deferred extended service contracts	632,893	914,254
Deferred in-service and training	22,500	17,500
Deferred service arrangements	79,500	80,000
Deferred service arrangement obligations	600	7,800
Recognized as revenue:		
Deferred extended service contracts	(732,218)	(1,084,345)
Deferred in-service and training	(25,000)	(10,000)
Deferred service arrangements	(108,328)	(71,919)
Deferred service arrangement obligations	(1,200)	(11,400)
Deferred revenue at end of period	1,486,800	1,598,241
Less: current portion	1,067,069	1,289,289
Long-term deferred revenue at end of period	$ 419,731	$ 308,952

NOTE G - SALE-LEASEBACK

In August 2007, the Company sold its warehouse and corporate facility for $1,400,000. Under the agreement, the Company is leasing back the property from the purchaser over a period of five years. The Company is accounting for the leaseback as an operating lease. The gain of $266,226 realized in this transaction has been deferred and is being amortized to income ratably over the term of the lease. At November 30, 2008 the unamortized deferred gain of $195,232 is shown as "Deferred gain on sale of building" in the Company's consolidated condensed balance sheet. The short-term portion of $53,245 is shown in current liabilities and the long-term portion of $141,987 is in long-term liabilities. The amount recognized as a gain in the first six months of fiscal 2009 was $26,623.

NOTE H - WARRANTY LIABILITY

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

	Six Months Ended November 30,	
	2008	2007
Warranty liability at the beginning of the period	$ 17,250	$ 15,750
Expense for new warranties issued	42,000	33,000
Warranty claims	(26,000)	(17,750)
Warranty liability at the end of the period	33,250	31,000
Long-term warranty liability at the end of the period	$ -	$ -

NOTE I - RELATED-PARTY TRANSACTIONS

On June 21, 2007, we entered into a Securities Purchase Agreement with Kerns. Concurrently with our entry into the Securities Purchase Agreement, we also entered into a Distribution Agreement and a Supplier Agreement with Living Data, an affiliate of Kerns.

We sold to Kerns, pursuant to the Securities Purchase Agreement, 21,428,572 shares of our common stock at $.07 per share for an aggregate of $1,500,000, as well a five-year warrant to purchase 4,285,714 shares of our common stock at an initial exercise price of $.08 per share (the "Warrant"). The agreement further provided for the appointment to our Board of Directors of two representatives of Kerns. In furtherance thereof, Jun Ma and Simon Srybnik, Chairman of both Kerns and Living Data, have been appointed members of our Board of Directors. On October 16, 2008 Mr. Jun Ma was appointed President and Chief Executive Officer of the Company. Pursuant to the Distribution Agreement, we have become the exclusive distributor in the United States of the AngioNew ECP systems manufactured by Living Data. As additional consideration for such agreement, we agreed to issue an additional 6,990,840 shares of our common stock to Living Data. Pursuant to the Supplier Agreement, Living Data is now the exclusive supplier to us of the ECP therapy systems that we market under the registered trademark EECP(R). The Distribution Agreement and the Supplier Agreement each have an initial term extending through May 31, 2012.

On November 20, 2008, the Company entered into an Amendment to the Distribution Agreement with Living Data to expand the territory covered in the Distribution Agreement to provide for exclusive distribution rights worldwide. In consideration for these rights, the Company agreed to issue Living Data 3,000,000 restricted shares of its common stock.

Pursuant to a Registration Rights Agreement, we granted to Kerns and Living Data, subject to certain restrictions, "piggyback registration rights" covering the shares sold to Kerns as well as the shares issuable upon exercise of the Warrant and the shares issued to Living Data.

On July 10, 2007, the Board of Directors appointed Behnam Movaseghi, Treasurer and Chief Financial Officer of Kerns Manufacturing Corporation, to our Board of Directors.

As affiliates of Living Data and Kerns, Mr. Movaseghi and Mr. Srybnik have each been directly involved in the transactions between Living Data or Kerns, on the one hand, and the Company, on the other hand, with respect to the Securities Purchase Agreement, the Distribution Agreement and the Supplier Agreement, as well as providing consulting services to the Company without compensation.

During the six-month period ended November 30, 2008, the Company purchased ECP therapy systems under the Supplier Agreement for $505,000 from Living Data. Payment terms on certain purchases leave a balance of $20,000 in due to related party-long term portion and $240,000 in due to related party-current portion on the accompanying balance sheet. In addition, Living Data purchased $3,162 worth of ECP therapy system components from the Company.

During the six-month period ended November 30, 2008, Living Data assigned to the Company all of its rights and interests under its Distributorship Agreement with a corporation organized and existing under the laws of the People's Republic of China that manufactures Ambulatory Blood Pressure Monitors,

Ambulatory ECG Recorders and Holter & ABPM Combiner Recorders, for $20,000 payable to Living Data based on certain terms and conditions. The Company has also agreed to pay to Living Data 5% of the selling price or 5% of the cost of all goods sold (whichever is higher) and 5% of the cost of all goods transferred but not sold under the Assignment Agreement to Living Data based on sales of this equipment. The Company intends to sell these systems in the United States and other countries subject to obtaining regulatory clearance.

During the six-month period ended November 30, 2008, Living Data assigned to the Company all of its rights and interests under its Distributorship Agreement with a corporation organized and existing under the laws of the People's Republic of China that manufactures Ultrasound Scanners, for $20,000 payable to Living Data based on certain terms and conditions. The Company has also agreed to pay to Living Data 5% of the selling price or 5% of the cost of all goods sold (whichever is higher) and 5% of the cost of all goods transferred but not sold under the Assignment Agreement to Living Data based on sales of this equipment. The Company intends to sell these systems in the United States and other countries subject to obtaining regulatory clearance.

Further, Kerns provides the Company, free of charge, part-time use of one of its Information Technology (IT) employees as well one of their IT consultants to provide the Company with IT and database support services. In addition, a clinical applications support specialist and a service engineer from Living Data may be used by the Company to provide customers with clinical training and technical service. The Company was charged $3,900 for the services of the clinical applications support specialist and $2,700 for the services of the service engineer during the six-month period ended November 30, 2008.

NOTE J - INCOME TAXES

During the six-month period ended November 30, 2008 and August 31, 2007, state income taxes were $7,500 and $10,447, respectively.

As of November 30, 2008, the recorded deferred tax assets were $20,095,252, reflecting a $275,900 increase during the first six months of fiscal 2009. The deferred tax assets were offset by a valuation allowance of the same amount. Ultimate realization of any or all of the deferred tax assets is not assured, due to significant uncertainties and material assumptions associated with estimates of future taxable income during the carryforward period. Management has concluded that, based upon the weight of available evidence, it was "more likely than not" that the net deferred tax asset would not be realized.

NOTE K - COMMITMENTS AND CONTINGENCIES

Leases

On August 15, 2007, we sold our facility under a five-year leaseback agreement. Future rental payments under the operating lease are as follows:

For the years ended:	
May 31, 2009	$ 72,081
May 31, 2010	148,488
May 31, 2011	154,427
May 31, 2012	160,604
May 31, 2013	40,541
Total	$ 576,141

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

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

General Overview

Vasomedical, Inc. was incorporated in Delaware in July 1987. Unless the context requires otherwise, all references to "we", "our", "us", "Company", "registrant", "Vasomedical" or "management" refer to Vasomedical, Inc. and its subsidiaries. Since 1995, we have been primarily engaged in designing, manufacturing, marketing and supporting EECP(R) enhanced external counterpulsation systems based on our unique proprietary technology currently indicated for use in cases of stable or unstable angina (i.e., chest pain), congestive heart failure (CHF), acute myocardial infarction (i.e., heart attack, (MI)) and cardiogenic shock. The EECP(R) therapy is a non-invasive, outpatient treatment of diseases of the cardiovascular system. The therapy serves to increase circulation in areas of the heart with less than adequate blood supply and helps to restore systemic vascular function. The therapy also increases blood flow and oxygen supply to the heart muscle and other organs and decreases the heart's workload and reduces oxygen demand, while also improving function of the endothelium, the lining of blood vessels throughout the body, lessening resistance to blood flow. We provide hospitals, clinics and physician private practices with EECP(R) equipment, treatment guidance, and a staff training and equipment maintenance program designed to provide optimal patient outcomes. EECP(R) is a registered trademark for Vasomedical's enhanced external counterpulsation therapy and systems. For more information, visit www.vasomedical.com.

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

During the last several years, we incurred operating losses. We have attempted to achieve profitability by reducing operating costs and halting the trend of declining revenue, and to reduce cash usage through bringing our cost structure more into alignment with current revenues. By engaging in restructurings during March 2007 and April 2007, the Company has substantially reduced personnel and spending on sales, marketing and development projects. In addition, during the first quarter of fiscal year 2008, we raised additional capital through a private equity financing and by the sale of our facility under a leaseback agreement. See Note A for details of these events.

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

Market Overview

Cardiovascular disease (CVD) is the leading cause of death in the world and is among the top three diseases in terms of healthcare spending in nearly every country. CVD claimed approximately 2.4 million lives in the United States in 2005 and was responsible for 1 of every 5 deaths, according to The American Heart Association (AHA) Heart and Stroke Statistical 2009 Update (2009 Update). Approximately 80 million Americans suffer from some form of cardiovascular disease. Among these, 16.8 million have coronary heart disease (CHD).

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

Angina

Angina pectoris is the medical term for a recurring pain or discomfort in the chest due to coronary artery disease (CAD). Angina is a symptom of a condition called myocardial ischemia, which occurs when the heart muscle or myocardium doesn't receive sufficient blood, hence as much oxygen, as it needs. This usually happens because one or more of the heart's arteries, the blood vessels that supply blood to the heart muscle, is narrow or blocked. Insufficient blood supply to meet the need of the organ to function is called ischemia.

The cardinal symptom of stable CAD is anginal chest pain or equivalent symptoms, such as exertional dyspnea or fatigue. Angina is uncomfortable pressure, fullness, squeezing or pain, usually occurring in the center of the chest under the breastbone. The discomfort also may be felt in the neck, jaw, shoulder, back or arm. Often the patient suffers not only from the discomfort of the symptom itself but also from the accompanying limitations on activities and the associated anxiety that the symptoms may produce. Uncertainty about prognosis may be an additional source of anxiety. For some patients, the predominant symptoms may be palpitations or syncope that is caused by arrhythmias or fatigue, edema, or orthopnea caused by heart failure. Episodes of angina occur when the heart's need for oxygen increases beyond the oxygen available from the blood nourishing the heart. Physical exertion is the most

common trigger, but not the only one for angina. For example, running to catch a bus could trigger an attack of angina while walking might not. Angina may happen during exercise, periods of emotional stress, exposure to extreme cold or heat, heavy meals, alcohol consumption or cigarette smoking. Some people, such as those with a coronary artery spasm, may have angina when they are resting.

There are approximately 6.4 million angina patients in the United States and our EECP(R) therapy currently competes with other technologies in the market for approximately 100,000 to 150,000 new refractory angina patients annually who do not adequately respond to or are not amenable to medical and surgical therapy and have the potential to meet the guidelines for reimbursement of EECP(R) therapy. Most angina patients are treated with medications, including beta blockers to slow and protect the heart, and vasodilators which are often prescribed to increase blood flow to the coronary arteries. When drugs fail or inadequately correct the problem, the patients are considered unresponsive to medical therapy. Most angina patients are readily amenable to invasive revascularization procedures such as angioplasty and coronary stent placement, as well as coronary artery bypass grafting (CABG). However, there are approximately 100,000 to 150,000 angina patients each year whose angina can not be stopped by medication and they are no longer readily amenable to palliative invasive procedures.

In February 1999, the Centers for Medicare and Medicaid Services (CMS), the federal agency that administers the Medicare program for more than 39 million beneficiaries, issued a national coverage policy for the use of external counterpulsation therapy in the treatment of refractory angina. Medicare reimbursement guidelines have a significant impact in determining the available market for EECP(R) therapy. We believe that over 65% of the patients that receive EECP(R) therapy are Medicare patients and many of the third-party payers follow Medicare guidelines, which limit reimbursement for EECP(R) therapy to

patients who do not adequately respond to or are not amenable to medical therapy and are not readily amenable to invasive therapy. As a result, an important element ofour strategy is to grow the market for EECP(R) therapy by expanding reimbursement coverage to include a broader range of angina patients than the current coverage policy provides and enable EECP(R) therapy to compete more with other therapies for ischemic heart disease. Please see the heading "Reimbursement" in the "Item-1 Business" section of this Form 10-KSB for a more detailed discussion of reimbursement issues.

Congestive Heart Failure (CHF)

CHF is a condition in which the heart loses its pumping capacity to supply the metabolic needs of all other organs. The condition affects both sexes and is most common in people over age 50. Symptoms include angina, shortness of breath, weakness, fatigue, swelling of the abdomen, legs and ankles, rapid or irregular heartbeat and low blood pressure. Causes range from chronic high blood pressure, heart-valve disease, heart attack, coronary artery disease, heartbeat irregularities, severe lung disease such as emphysema, congenital disease, cardiomyopathy, hyperthyroidism, severe anemia and others.

CHF is treated with medication and, sometimes, surgery on heart valves or the coronary arteries and, in certain severe cases, heart transplants. Left ventricular assist devices (LVADs) and the use of cardiac resynchronization and

implantable defibrillators are useful in selected patients with heart failure. Still, no consensus therapy currently exists for CHF and patients must currently suffer their symptoms chronically and have a reduced life expectancy.

According to the 2009 Update, in 2005 approximately 3.2 million men and 2.5 million women in the United States had CHF and about 670,000 new cases of the disease occur each year. The prevalence of the disease is growing as a result of the aging of the population and the improved survival rate of people after heart attacks. Because the condition frequently entails visits to the emergency room and in-patient treatment centers, two-thirds of all hospitalizations for people over age 65 are due to CHF. The economic burden of congestive heart failure is enormous with an estimated cost to the health care system in 2005 in the United States of $37.2 billion. Congestive heart failure offers a good strategic fit with our current angina business and offers an expanded market opportunity for EECP(R) therapy. Unmet clinical needs in CHF are greater than those for angina, as there are few consensus therapies, invasive or otherwise, beyond medical management for the condition. It is noteworthy that data collected from the International EECP(R) Patient Registry(TM) (IEPR) at the University of Pittsburgh Graduate School of Public Health shows that approximately one-third of angina patients treated with EECP(R) also have a history of CHF and 70% to 80% have demonstrated positive outcomes from EECP(R) therapy.

We sponsored a pivotal, randomized clinical trial to demonstrate the efficacy of EECP(R) therapy in the most prevalent types of heart failure patients. This trial, known as PEECH(TM) (Prospective Evaluation of EECP(R) in Congestive Heart Failure), was intended to provide additional evidence of the safety and efficacy of EECP(R) therapy in the treatment of mild-to-moderate heart failure and to support our application for expansion of the Medicare national reimbursement coverage policy to include mild-to-moderate heart failure as a primary indication. The PEECH(TM) trial was a positive clinical trial, having met the statistical requirement of meeting at least one of its co-primary endpoints, a significant difference in the proportion of patients satisfying a prespecified threshold of improvement in exercise duration. The trial also demonstrated significant improvements in favor of EECP(R) therapy on several important secondary endpoints, including exercise duration and improvement in symptom status and quality of life. Measures of change in peak oxygen consumption were not statistically significant in the overall study population, though a trend favoring EECP(R) therapy was present in early follow-up. Patients in the trial who had an ischemic etiology (i.e. pre-existing coronary artery disease), demonstrated a greater response to EECP(R) therapy than those who had an idiopathic (non-ischemic) etiology.

The preliminary results of the PEECH(TM) trial were presented at the American College of Cardiology scientific sessions in March 2005. On June 20, 2005, CMS accepted our application for expansion of reimbursement coverage of

EECP(R) therapy to include patients with New York Heart Association (NYHA) Class II/III stable heart failure symptoms with an ejection fraction of less than or equal to 35% (i.e. chronic, stable, mild-to-moderate systolic heart failure as a primary indication), as well as patients with Canadian Cardiovascular Society Classification (CCSC) II (i.e. chronic, stable mild angina).

On June 23, 2005, CMS also received a request from a competing manufacturer of external counterpulsation therapy equipment to reconsider the reimbursement coverage policy. They requested expansion of coverage to include 1) treatment of

congestive heart failure, to include NYHA Class II, III with a left ventricular ejection fraction (LVEF) less than or equal to 40%, and acute heart failure; 2) treatment of stable angina to include CCSC II angina; 3) treatment of acute myocardial infarction; and 4) treatment of cardiogenic shock. On September 15, 2005, the competing manufacturer also amended their request to include NYHA Class IV heart failure.

On March 20, 2006, CMS issued their Decision Memorandum regarding this reconsideration with the opinion "that the evidence is not adequate to conclude that external counterpulsation therapy is reasonable and necessary for the treatment of:

- o CCSC II angina
- o Heart Failure
  - 0 NYHA Class II/III stable heart failure symptoms with an ejection fraction of less than or equal to 35%
  - 0 NYHA Class II/III stable heart failure symptoms with an ejection fraction of less than or equal to 40%
  - 0 NYHA Class IV heart failure
  - 0 Acute heart failure
- o Cardiogenic shock
- o Acute myocardial infarction."

They did, however, reiterate in the decision memorandum that "Current coverage as described in Section 20.20 of the Medicare National Coverage Determination (NCD) manual will remain in effect" for refractory angina patients.

On August 25, 2006 the results of the trial were initially published online by the Journal of the American College of Cardiology (JACC) and in print in its September 19, 2006 issue. JACC is the official journal of the American College of Cardiology.

In the November-December issue of the journal Congestive Heart Failure, a second report of results from the PEECH(TM) trial was published, focusing on the results of a prespecified subgroup analysis in trial patients age 65 and over. This analysis demonstrated a statistically positive response on both co-primary endpoints of the trial in patients receiving EECP(R) therapy versus those who did not, i.e. a significantly larger proportion of patients undergoing EECP(R) therapy met or exceeded prespecified thresholds of improvement in exercise duration and peak oxygen consumption. Moreover, the patients age 65 and older who received EECP(R) therapy demonstrated the greatest differences in exercise duration, peak oxygen consumption and functional class (symptom status) compared with those who did not receive EECP(R) therapy.

These papers were submitted to CMS and we were advised to continue to gather more clinical evidence for future submission.

We will continue to educate the marketplace that EECP(R) therapy is a therapy for ischemic cardiovascular disease and that patients with a primary diagnosis of heart failure, diabetes, peripheral vascular disease, etc. are also eligible for reimbursement under the current coverage policy, provided the

primary indication for treatment with EECP(R) therapy is refractory angina or angina equivalent symptoms and the patient satisfies other listed criteria.

Additionally, we intend to continue to pursue expansion of coverage for EECP(R) therapy with Medicare and other third-party payers as evidence of its clinical utility develops.

Critical Accounting Policies

Financial Reporting Release No. 60, which was released by the Securities and Exchange Commission, (SEC), in December 2001, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note B of the Notes to Consolidated Condensed Financial Statements included in our Annual Report on Form 10-KSB for the year ended May 31, 2008, includes a summary of our significant accounting policies and methods used in the preparation of our financial statements. In preparing these financial statements, we have made our best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. The application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. Our critical accounting policies are as follows:

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, the price is fixed or determinable and collectibility is reasonably assured. In the United States, we recognize revenue from the sale of our EECP(R) systems in the period in which we deliver the system to the customer. Revenue from the sale of our EECP(R) systems to international markets is recognized upon shipment of the product to a common carrier, as are supplies, accessories and spare parts delivered to both domestic and international customers. Returns are accepted prior to the in-service and training subject to a 10% restocking charge or for normal warranty matters, and we are not obligated for post-sale upgrades to these systems. In addition, we use the installment method to record revenue based on cash receipts in situations where the account receivable is collected over an extended period of time and in our judgment the degree of collectibility is uncertain.

In most cases, revenue from domestic EECP(R) system sales is generated from multiple-element arrangements that require judgment in the areas of customer acceptance, collectibility, the separability of units of accounting, and the fair value of individual elements. We follow the provisions of Emerging Issues Task Force, or EITF, Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21"). The principles and guidance outlined in EITF 00-21 provide a framework to determine (a) how the arrangement consideration should be measured (b) whether the arrangement should be divided into separate units of accounting, and (c) how the arrangement consideration should be allocated among the separate units of accounting. We determined that the domestic sale of our EECP(R) systems includes a combination of three elements that qualify as separate units of accounting:

i. EECP(R) equipment sale,
ii. provision of in-service and training support consisting of equipment set-up and training provided at the customer's facilities, and
iii. a service arrangement (usually one year), consisting of: service by factory-trained service representatives, material and labor costs, emergency and remedial service visits, software upgrades, technical phone support and preferred response times.

Each of these elements represent individual units of accounting as the delivered item has value to a customer on a stand-alone basis, objective and reliable evidence of fair value exists for undelivered items, and arrangements normally do not contain a general right of return relative to the delivered

item. We determine fair value based on the price of the deliverable when it is sold separately or based on third-party evidence. In accordance with the guidance in EITF 00-21, we use the residual method to allocate the arrangement consideration when it does not have fair value of the EECP(R) system sale. Under the residual method, the amount of consideration allocated to the delivered item equals the total arrangement consideration less the aggregate fair value of the undelivered items. Assuming all other criteria for revenue recognition have been met, we recognize revenue for:

i. EECP(R) equipment sales, when delivery and acceptance occurs based on delivery and acceptance documentation received from independent shipping companies or customers,
ii. in-service and training, following documented completion of the training, and
iii. the service arrangement, ratably over the service period, which is generally one year.

In-service and training generally occurs within a few weeks of shipment and our return policy states that no returns will be accepted after in-service and training has been completed. The amount related to in-service and training is recognized as service revenue at the time the in-service and training is completed and the amount related to service arrangements is recognized ratably as service revenue over the related service period, which is generally one year. Costs associated with the provision of in-service and training and the service arrangement, including salaries, benefits, travel, spare parts and equipment, are recognized in cost of equipment sales as incurred.

The Company also recognizes revenue generated from servicing EECP(R) systems that are no longer covered by the service arrangement, or by providing sites with additional training, in the period that these services are provided. Revenue related to future commitments under separately priced extended service agreements on our EECP(R) system are deferred and recognized ratably over the service period, generally ranging from one year to four years. Costs associated with the provision of service and maintenance, including salaries, benefits, travel, spare parts and equipment, are recognized in cost of sales as incurred. Amounts billed in excess of revenue recognized are included as deferred revenue in the consolidated condensed balance sheets.

Revenues from the sale of EECP(R) systems through our international distributor network are generally covered by a one-year warranty period. For these customers we accrue a warranty reserve for estimated costs to provide warranty parts when the equipment sale is recognized.

The Company has also entered into lease agreements for our EECP(R) systems, generally for terms of one year or less, that are classified as operating leases. Revenues from operating leases are generally recognized, in accordance with the terms of the lease agreements, on a straight-line basis over the life of the respective leases. For certain operating leases in which payment terms are determined on a "fee-per-use" basis, revenues are recognized as incurred (i.e., as actual usage occurs). The cost of the EECP(R) system utilized under operating leases is recorded as a component of property and equipment and is amortized to cost of sales over the estimated useful life of the equipment, not to exceed five years. There were no significant minimum rental commitments on these operating leases at November 30, 2008.

Accounts Receivable, net

The Company's accounts receivable are due from customers engaged in the provision of medical services. Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are generally due 30 to 90 days from shipment and are stated at amounts due from customers net of allowances for doubtful accounts, returns, term discounts and other allowances. Accounts that remain outstanding longer than the contractual payment terms are considered past due. Estimates are used in determining the allowance for doubtful accounts based on the Company's historical collections experience, current trends, credit policy and a percentage of its accounts receivable by aging category. In determining these percentages, we look at historical write-offs of our receivables. The Company also looks at the credit quality of its customer base as well as changes in its credit policies. The Company continuously monitors collections and payments from our customers. While credit losses have historically been within expectations and the provisions established, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has in the past.

Inventories, net

The Company values inventory at the lower of cost or estimated market, cost being determined on a first-in, first-out basis. The Company often places EECP(R) systems at various field locations for demonstration, training,

evaluation, and other similar purposes at no charge. The cost of these EECP(R) systems is transferred to property and equipment and is amortized over the next two to five years. The Company records the cost of refurbished components of EECP(R) systems and critical components at cost plus the cost of refurbishment. The Company regularly reviews inventory quantities on hand, particularly raw materials and components, and records a provision for excess and obsolete inventory based primarily on existing and anticipated design and engineering changes to its products as well as forecasts of future product demand.

We have adopted the provisions of Statement of Financial Accounting Standards No. 151, "Inventory Costs", on a prospective basis. The statement clarifies that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. As a result of adopting SFAS No. 151, we absorbed approximately $73,000 more in fixed production overhead into inventory during the first six months of fiscal year 2009 as compared to the same period in fiscal 2008.

Deferred Revenues

The Company records revenue on extended service contracts ratably over the term of the related contract period. In accordance with the provisions of EITF 00-21, we began to defer revenue related to EECP(R) system sales for the fair value of installation and in-service training to the period when the services are rendered and for warranty obligations ratably over the service period, which is generally one year.

Warranty Costs

Equipment sold is generally covered by a warranty period of one year. Under the provisions of EITF 00-21, for certain arrangements, a portion of the overall system price attributable to the first year service arrangement is deferred and recognized as revenue over the service period. As such, we do not accrue warranty costs upon delivery but we rather recognize warranty and related service costs as incurred.

Equipment sold to international customers through our distributor network is generally covered by a one-year warranty period. For these customers the Company accrues a warranty reserve for estimated costs of providing a parts only warranty when the equipment sale is recognized.

The factors affecting our warranty liability included the number of units sold and historical and anticipated rates of claims and costs per claim.

Net Loss per Common Share

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

Income Taxes

Deferred income taxes are recognized for temporary differences between financial statement and income tax bases of assets and liabilities and loss carryforwards for which income tax benefits are expected to be realized in future years. A valuation allowance is established, when necessary, to reduce deferred tax assets to the amount expected to be realized. In estimating future tax consequences, we generally consider all expected future events other than an enactment of changes in the tax laws or rates. The deferred tax asset is

continually evaluated for realizability. To the extent our judgment regarding the realization of the deferred tax assets changes, an adjustment to the allowance is recorded, with an offsetting increase or decrease, as appropriate, in income tax expense. Such adjustments are recorded in the period in which our estimate as to the realizability of the asset changed that it is "more likely than not" that all of the deferred tax assets will be realized. The "more likely than not" standard is subjective, and is based upon our estimate of a greater than 50% probability that the deferred tax asset will be realized.

Deferred tax assets and liabilities are classified as current or non-current based on the classification of the related asset or liability for financial reporting. A deferred tax asset or liability that is not related to an asset or liability for financial reporting, including deferred tax assets related to carryforwards, are classified according to the expected reversal date of the temporary difference. The deferred tax asset the Company previously recorded, and then reversed fully in fiscal 2006, related primarily to the realization of net operating loss carryforwards, of which the allocation of the

current portion, if any, reflected the expected utilization of such net operating losses for the following twelve months. Such allocation was based on the Company's internal financial forecast and may be subject to revision based upon actual results.

Stock-based Employee Compensation

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

As new stock options are issued by the Company this may have a material effect on its quarterly and annual financial statements, in the form of additional compensation expense. It is not possible to precisely determine the expense impact of adoption since a portion of the ultimate expense that is recorded will likely relate to awards that have not yet been granted. The expense associated with these future awards can only be determined based on factors such as the price for the Company's common stock, volatility of the Company's stock price and risk free interest rates as measured at the grant date.

For purposes of estimating the fair value of each option on the date of grant, the Company utilizes the Black-Scholes option-pricing model.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable measure of the fair value of its employee stock options.

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

Recently Issued Accounting Pronouncements Not Yet Effective

SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" -- changes the way the consolidated income statement is presented. It requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also

requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. Previously, net income attributable to the

noncontrolling interest generally was reported as an expense or other deduction in arriving at consolidated net income. It also was often presented in combination with other financial statement amounts. Effective for fiscal years beginning after December 15, 2008.

FSP APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" -- clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) are not addressed by paragraph 12 of APB Opinion No. 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants. Additionally, this FSP specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years.

FSP FAS 142-3, "Determination of the Useful Life of Intangible Assets" -- amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets. Paragraph 11(d) of Statement 142 precluded an entity from using its own assumptions about renewal or extension of an arrangement where there is likely to be substantial cost or material modifications. This FSP amends paragraph 11(d) of Statement 142 so that an entity will use its own assumptions about renewal or extension of an arrangement, adjusted for the entity-specific factors in paragraph 11 of Statement 142, even when there is likely to be substantial cost or material modifications. Therefore, in determining the useful life of the asset for amortization purposes, an entity shall consider the period of expected cash flows used to measure the fair value of the recognized intangible asset, adjusted for the entity-specific factors including, but are not limited to, the entity's expected use of the asset and the entity's historical experience in renewing or extending similar arrangements. This FSP shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited.

Results of Operations

Three Months Ended November 30, 2008 and 2007

Net revenue from sales, leases and service of our EECP(R) systems for the three months ended November 30, 2008 and 2007, was $1,158,825 and $1,387,815, respectively, which represented a decrease of $228,990, or 17%. We reported a net loss attributable to common stockholders of $267,244 and $64,063 for the second quarter of fiscal 2009 and 2008, respectively. The increase in the net loss was primarily due to a decrease in service related revenues compared to the same period of the prior year.

Revenues

Revenue from equipment sales decreased approximately 2% to $588,298 for the three-month period ended November 30, 2008 as compared to $597,292 for the same period in the prior year. The decrease in equipment sales is due primarily to a 13% decrease in the average blended per unit sale price offset by a slight increase in the number of equipment shipments.

We believe the decline in the sales price per unit reflects weakened domestic demand in the refractory angina market as existing capacity is more fully utilized, coupled with increased direct and indirect competition. We anticipate that demand for EECP(R) systems will remain soft unless there is greater clinical acceptance for the use of EECP(R) therapy in treating patients with angina or angina equivalent symptoms who meet the current reimbursement

guidelines or an expansion of the current CMS national reimbursement policy to include some or all Class II & III heart failure patients. Patients with angina or angina equivalent symptoms eligible for reimbursement under current policies

include many with serious comorbidities, such as heart failure, diabetes, peripheral vascular disease and/or others.

Our revenue from the sale of EECP(R) systems and related products to international distributors in the second quarter of fiscal 2009 increased approximately 13% compared to the same three-month period in the prior year reflecting increased sales volume. We believe this reflects an expansion of our international market.

Our revenue from equipment rental and services decreased 28% to $570,527 in the second quarter of fiscal 2009 from $790,543 in the second quarter of fiscal year 2008. Revenue from equipment rental and services represented 49% of total revenue in the second quarter of fiscal 2009 and 57% in the same quarter of fiscal 2008. The decrease in revenue generated from equipment rentals and services is due to a decrease in the service business, with respect to service contract sales, and service related income generated from units not under contract, as well as, a decrease in accessories and service parts shipped compared to the same quarter of the prior fiscal year.

Gross Profit

Gross profit declined to $535,764, or 46% of revenues, for the second quarter of fiscal 2009 compared to $651,775, or 47% of revenues, for the same quarter of fiscal 2008. Gross profits are dependent on a number of factors, particularly the mix of new and used EECP(R) systems and the mix of models sold, their respective average selling prices, the mix of EECP(R) units sold, rented or placed during the period, the ongoing costs of servicing EECP(R) systems, and certain fixed period costs, including facilities, payroll and insurance.

Selling, General and Administrative

Selling, general and administrative ("SG&A") expenses for the second quarter of fiscal 2009 and 2008 were $685,384, or 59% of revenues, and $642,138, or 46% of revenues, respectively, reflecting an increase of $43,246 or approximately 7%. The increase in SG&A expenditures in the second quarter of fiscal 2009 resulted primarily from increased direct expenditures in sales and marketing. Administrative expenses decreased as a result of decreased expenditures in wages and benefits, professional fees, and insurance expenses.

During the second quarter of fiscal 2009 and 2008, there were no changes in the Company's provision for doubtful accounts.

Research and Development

Research and development ("R&D") expenses of $147,607, or 13% of revenues, for the second quarter of fiscal 2009 increased by $41,780, or 39%, from $105,827, or 8% of revenues, for the second quarter of fiscal 2008. The increase is primarily attributable to an increase in expenses paid to fund clinical research studies, and product development costs, offset by a decrease in regulatory affairs expenses.

Interest and Other Income, Net

Interest and other income for the second quarter of 2009 and 2008, were $20,523 and $22,967, respectively. Interest income reflects interest earned on the Company's cash balances.

Recognition of Deferred Gain on Sale of Building

The recognition of deferred gain on sale of building for the second quarter of 2009 and 2008, were $13,312 and $13,311, respectively. The gain resulted from the Company's sale-leaseback of its facility. See Note G.

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

Income Tax Expense, Net

During the second quarter of fiscal 2009 and 2008, we recorded a provision for income taxes of $3,852 and $4,151, respectively.

As of November 30, 2008, the recorded deferred tax assets were $20,095,252, reflecting an increase of $93,400 during the second quarter of fiscal 2009, which was offset by a valuation allowance of the same amount.

Ultimate realization of any or all of the deferred tax assets is not assured due to significant uncertainties and material assumptions associated with estimates of future taxable income during the carryforward period. In November 2005, we concluded that, based upon the weight of available evidence, it was "more likely than not" that the net deferred tax asset would not be realized and increased the valuation allowance to bring the net deferred tax asset carrying value to zero.

Six Months Ended November 30, 2008 and 2007

Net revenue from sales, leases and service of our EECP(R) systems for the six months ended November 30, 2008 and 2007, was $2,470,546 and $2,727,891, respectively, which represented a decrease of $257,345, or 9%. We reported a net loss attributable to common stockholders of $817,215 and $82,848 for the first six months of fiscal 2009 and 2008, respectively. The increase in the net loss was primarily due to increases in our operating expenses, and decreases in revenue from the comparative prior period.

Revenues

Revenue from equipment sales increased $154,254, or approximately 14% to $1,244,794 for the six-month period ended November 30, 2008 as compared to $1,090,540 for the same period in the prior year. The increase in equipment sales is due primarily to a 23% increase in the number of equipment shipments offset by a moderate decrease in the average blended per unit sale price.

Our revenue from the sale of EECP(R) systems and related products to international distributors in the first six months of fiscal 2009 increased approximately 37% compared to the same six-month period in the prior year reflecting increased sales volume. We believe this reflects an expansion of our international market.

Our revenue from equipment rental and services decreased 26% to $1,225,752

in the first six months of fiscal 2009 from $1,637,351 in the first six months of fiscal year 2008. Revenue from equipment rental and services represented 50% of total revenue in the first six months of fiscal 2009 and 60% in the same quarters of fiscal 2008. The decrease in revenue generated from equipment rentals and services is due to a decrease in the service business, with respect to service contract sales, and service related income generated from units not under contract, as well as, a decrease in accessories and service parts shipped compared to the same quarter of the prior fiscal year.

Gross Profit

Gross profit declined to $1,036,326, or 42% of revenues, for the first six months of fiscal 2009 compared to $1,336,514, or 49% of revenues, for the same period of fiscal 2008. Gross profits are dependent on a number of factors, particularly the mix of new and used EECP(R) systems and the mix of models sold, their respective average selling prices, the mix of EECP(R) units sold, rented or placed during the period, the ongoing costs of servicing EECP(R) systems, and certain fixed period costs, including facilities, payroll and insurance.

Selling, General and Administrative

Selling, general and administrative ("SG&A") expenses for the first six months of fiscal 2009 and 2008 were $1,629,143, or 66% of revenues, and $1,200,294, or 44% of revenues, respectively, reflecting an increase of $428,849

or approximately 36%. The increase in SG&A expenditures in the first six months of fiscal 2009 resulted primarily from increased direct expenditures in sales and marketing. Administrative expenses increased as a result of increased expenditures in wages and benefits, professional fees, and corporate expenses.

During the first six months of fiscal 2009 and 2008, there were no changes in the Company's provision for doubtful accounts.

Research and Development

Research and development ("R&D") expenses of $279,954, or 11% of revenues, for the first six months of fiscal 2009 increased by $34,952, or 14%, from $245,002, or 9% of revenues, for the first six months of fiscal 2008. The increase is primarily attributable to an increase in expenses paid to fund clinical research studies, and product development costs.

Interest Expense and Financing Costs

The Company had no interest expense and financing costs for the first six months of fiscal 2009 and $16,605 in the same period of 2008. Interest expense primarily reflects interest on loans secured to refinance the November 2000 purchase of the Company's headquarters and warehouse facility. The decrease is a direct result of the sale-leaseback agreements for the Company's headquarters and warehouse facility, which occurred during the first quarter of fiscal 2008

Interest and Other Income, Net

Interest and other income for the first six months of 2009 and 2008, were $36,535 and $35,238, respectively. Interest income reflects interest earned on the Company's cash balances.

Recognition of Deferred Gain on Sale of Building

The recognition of deferred gain on sale of building for the first six months of 2009 and 2008, were $26,623 and $17,748, respectively. The gain resulted from the Company's sale-leaseback of its facility. See Note G.

Income Tax Expense, Net

During the first six months of fiscal 2009 and 2008, we recorded a provision for income taxes of $7,602 and $10,447, respectively.

As of November 30, 2008, the recorded deferred tax assets were $20,095,252, reflecting an increase of $275,900 during the first six months of fiscal 2009, which was offset by a valuation allowance of the same amount.

Ultimate realization of any or all of the deferred tax assets is not assured due to significant uncertainties and material assumptions associated with estimates of future taxable income during the carryforward period. In November 2005, we concluded that, based upon the weight of available evidence, it was "more likely than not" that the net deferred tax asset would not be realized and increased the valuation allowance to bring the net deferred tax asset carrying value to zero.

Liquidity and Capital Resources

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

Cash and Cash Flow

We have financed our operations primarily from working capital, a private equity financing, and by the sale of our facility under a leaseback agreement. At November 30, 2008, we had cash and cash equivalents of $1,873,689 and working capital of $2,104,636 compared to cash and cash equivalents of $2,653,999 and working capital of $2,851,901 at May 31, 2008.

Cash used in operating activities was $770,872 during the first six months of fiscal 2009, which consisted of a net cash loss after adjustments of $600,414 and cash used by operating assets and liabilities of $170,458. The changes in the accounts balances primarily reflects increases in inventory of $145,351, including $95,921 of inventories transferred to property and equipment, and other current assets of $46,333, a decrease in accounts payable, accrued expenses, and other current liabilities of $387,422, and a decrease in other liabilities of $65,877 which were primarily offset by a decrease in accounts receivable of $214,525 and due to related party of $260,000. Net accounts receivable were 20% of revenues for the six-month period ended November 30, 2008, as compared to 32% for the six-month period ended November 30, 2007, and accounts receivable turnover was 6 times for the six months ended November 30, 2008 and November 30, 2007.

Standard payment terms on our domestic equipment sales are generally net 30 to 90 days from shipment and do not contain "right of return" provisions. We have historically offered a variety of extended payment terms, including sales-type leases, in certain situations and to certain customers in order to expand the market for our EECP(R) therapy system products in the US and internationally. Such extended payment terms were offered in lieu of price concessions, in competitive situations, when opening new markets or geographies

and for repeat customers. Extended payment terms cover a variety of negotiated terms, including payment in full - net 120, net 180 days or some fixed or variable monthly payment amount for a six to twelve month period followed by a balloon payment, if applicable. During the six-month periods ended November 30, 2008 and 2007, there were no revenues generated from sales in which initial payment terms were greater than 90 days and we offered no sales-type leases during either period. In general, reserves are calculated on a formula basis considering factors such as the aging of the receivables, time past due, and the customer's credit history and their current financial status. In most instances where reserves are required, or accounts are ultimately written-off, customers have been unable to successfully implement their EECP(R) therapy program. As we are creating a new market for the EECP(R) therapy and recognizing the challenges that some customers may encounter, we have opted, at times, on a customer-by-customer basis, to recover our equipment instead of pursuing other legal remedies, which has resulted in our recording of a reserve or a write-off.

Investing activities used net cash of $9,438 for the purchase of fixed assets during the six-month period ended November 30, 2008.

The Company had no financing activities during the six-month period ended November 30, 2008.

The following table presents the Company's expected cash requirements for contractual obligations outstanding as of November 30, 2008.

	Total	Due thru 12/1/2008 and 11/30/2009	Due thru 12/1/2009 and 11/30/2011	Due thru 12/1/2011 and 11/30/2013	T
Operating Leases	$ 576,141	$ 145,604	$ 308,914	$ 121,623	
Due to related party	260,000	240,000	20,000	-	
Total Contractual Cash Obligations	$ 836,141	$ 385,604	$ 328,914	$ 121,623	

Liquidity

During the first quarter of fiscal 2008, events took place that allowed us to raise additional capital through a private equity financing and by the sale of our facility under a leaseback agreement. See Note A for details of these events.

Based on our current operations and the amounts received from the transactions described in Note A, we believe that we have sufficient working capital to continue our operations through at least November 30, 2009.

Effects of Current Economic Conditions

We do not believe that the current lack of credit available in the market will have an impact on our revenue or on our results of operations.

Vasomedical, Inc. and Subsidiaries

ITEM 3. - CONTROLS AND PROCEDURES

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Accountant, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Accountant concluded that, as of November 30, 2008, our disclosure controls and procedures are effective to provide reasonable assurances that such disclosure controls and procedures satisfy their objectives and that the information required to be disclosed by us in the reports we file under the Exchange Act is recorded, processed, summarized and reported within the required time periods. There were no changes during the fiscal quarter ended November, 2008 in our internal controls or in other factors that could have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 6 - EXHIBITS:

Exhibits

31 Certifications pursuant to Rules 13a-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certifications pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

VASOMEDICAL, INC.

By: /s/ Jun Ma

Jun Ma
President & Chief Executive Officer
(Principal Executive Officer)

/s/ Dave Singh

Dave Singh
Chief Accountant

Date: January 14, 2009