

VASOMEDICAL, INC  
Form 10-Q  
November 20, 2012

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2012

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  
(State or other jurisdiction of  
incorporation or organization)

11-2871434  
(IRS Employer Identification Number)

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

Registrant's Telephone Number (516) 997-4600

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

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company

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

Number of Shares Outstanding of Common Stock, \$.001 Par Value, at November 15, 2012 – 162,917,996

Vasomedical, Inc. and Subsidiaries

INDEX

<u>PART I – FINANCIAL INFORMATION</u>	<u>3</u>
<u>ITEM 1 - FINANCIAL STATEMENTS (unaudited)</u>	<u>3</u>
<u>CONSOLIDATED CONDENSED BALANCE SHEETS as of September 30, 2012 and December 31, 2011</u>	<u>3</u>
<u>CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS for the Three and Nine months ended September 30, 2012 and September 30, 2011</u>	<u>4</u>
<u>CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS for the Nine months ended September 30, 2012 and September 30, 2011</u>	<u>5</u>
<u>NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS</u>	<u>6</u>
<u>ITEM 2 - MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	<u>18</u>
<u>ITEM 4 - CONTROLS AND PROCEDURES</u>	<u>25</u>
<u>PART II - OTHER INFORMATION</u>	<u>26</u>
<u>ITEM 6 – EXHIBITS:</u>	<u>26</u>

## ITEM 1 - FINANCIAL STATEMENTS

Vasomedical, Inc. and Subsidiaries

## CONSOLIDATED CONDENSED BALANCE SHEETS

(in thousands, except share data)

	September 30, 2012 (unaudited)	December 31, 2011 (a) (audited)
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$9,691	\$2,294
Short-term investments	110	110
Accounts and other receivables, net of an allowance for doubtful accounts and commission adjustments of \$2,086 at September 30, 2012 and \$2,163 at December 31, 2011	8,388	20,695
Receivables due from related parties	41	196
Inventories, net	2,461	2,421
Financing receivables, net	21	19
Deferred commission expense	2,577	2,053
Deferred related party consulting expense - current portion	213	510
Other current assets	354	202
Total current assets	23,856	28,500
PROPERTY AND EQUIPMENT, net of accumulated depreciation of \$1,564 at September 30, 2012 and \$1,774 at December 31, 2011	628	429
GOODWILL	3,200	3,168
FINANCING RECEIVABLES, net	-	16
DEFERRED RELATED PARTY CONSULTING EXPENSE	-	85
OTHER ASSETS, net	1,825	2,137
	\$29,509	\$34,335
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$312	\$273
Accrued commissions	1,944	3,889
Accrued expenses and other liabilities	3,334	2,560
Sales tax payable	355	355
Income taxes payable	(37 )	278
Deferred revenue - current portion	10,102	9,484
Deferred gain on sale-leaseback of building - current portion	-	31
Deferred tax liability, net	112	112
Notes payable due to related party	3	193
Total current liabilities	16,125	17,175
<b>LONG-TERM LIABILITIES</b>		
Deferred revenue	4,896	5,743
Other long-term liabilities	127	141
Total long-term liabilities	5,023	5,884
<b>COMMITMENTS AND CONTINGENCIES (NOTE N)</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock, \$.01 par value; 1,000,000 shares authorized; nil shares		

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issued and outstanding at September 30, 2012, and December 31, 2011	-	-
Common stock, \$.001 par value; 250,000,000 shares authorized; 162,917,996 and 153,186,295 shares issued and outstanding at September 30, 2012 and December 31, 2011	163	153
Additional paid-in capital	60,993	60,188
Accumulated deficit	(52,823 )	(49,065 )
Accumulated other comprehensive income	28	-
Total stockholders' equity	8,361	11,276
	\$29,509	\$34,335

(a) Retroactively adjusted to give effect to measurement period adjustment (see Note I)

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

## Vasomedical, Inc. and Subsidiaries

## CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(Unaudited)

(in thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
<b>Revenues</b>				
Equipment sales	\$688	\$410	\$3,197	\$1,495
Equipment rentals and services	375	390	1,407	1,509
Commissions	4,659	5,730	14,858	13,545
Total revenues	5,722	6,530	19,462	16,549
<b>Cost of revenues</b>				
Cost of sales, equipment	282	200	1,304	949
Cost of equipment rentals and services	148	157	699	635
Cost of commissions	1,229	1,454	3,685	3,503
Total cost of revenues	1,659	1,811	5,688	5,087
Gross profit	4,063	4,719	13,774	11,462
<b>Operating expenses</b>				
Selling, general and administrative	6,591	4,553	17,256	12,497
Research and development	131	140	403	382
Total operating expenses	6,722	4,693	17,659	12,879
Operating (loss) income	(2,659 )	26	(3,885 )	(1,417 )
<b>Other income (expenses)</b>				
Interest and financing costs	-	(3 )	(3 )	(28 )
Interest and other income, net	93	33	123	51
Amortization of deferred gain on sale-leaseback of building	4	13	31	40
Total other income (expenses), net	97	43	151	63
(Loss) income before income taxes	(2,562 )	69	(3,734 )	(1,354 )
Income tax (expense) benefit	44	(5 )	(72 )	(4 )
Net (loss) income	(2,518 )	64	(3,806 )	(1,358 )
Preferred stock dividends	-	(1,180 )	-	(1,459 )
Net (loss) income applicable to common stockholders	(2,518 )	(1,116 )	(3,806 )	(2,817 )
<b>Other comprehensive income (loss)</b>				
Foreign currency translation gain	30	2	29	2
Comprehensive loss	\$(2,488 )	\$(1,114 )	\$(3,777 )	\$(2,815 )
<b>Loss per common share</b>				
- basic and diluted	\$(0.02 )	\$(0.01 )	\$(0.02 )	\$(0.02 )

Weighted average common shares outstanding				
- basic and diluted	159,018	149,524	157,162	126,023

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

## Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS  
(Unaudited)

(in thousands)

	Nine months ended	
	September 30, 2012	September 30, 2011
Cash flows from operating activities		
Net loss	\$(3,806 )	\$(1,358 )
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation and amortization	296	118
Amortization of deferred gain on sale-leaseback of building	(31 )	(40 )
Provision for doubtful accounts and commission adjustments	(7 )	15
Amortization of deferred distributor costs	-	177
Share-based compensation	559	295
Amortization of deferred consulting expense	416	367
Changes in operating assets and liabilities:		
Accounts and other receivables	12,212	3,516
Receivables due from related parties	159	-
Inventories, net	(47 )	(804 )
Finance receivables	14	13
Deferred commission expense	(525 )	(719 )
Other current assets	(170 )	55
Other assets	172	96
Accounts payable	39	(368 )
Accrued commissions	(1,945 )	840
Accrued expenses and other liabilities	813	(73 )
Sales tax payable	(1 )	45
Income taxes payable	(315 )	4
Deferred revenue	(229 )	838
Trade payable due to related party	-	(243 )
Other long-term liabilities	(26 )	(589 )
Net cash provided by operating activities	7,578	2,185
Cash flows from investing activities		
Purchases of property and equipment	(344 )	(21 )
Purchases of short-term investments	-	(41 )
Acquisition of Fast Growth Enterprises	-	(1,000 )
Cash acquired through purchase of Fast Growth Enterprises	-	442
Net cash used in investing activities	(344 )	(620 )
Cash flows from financing activities		
Proceeds from exercise of warrant	343	-
Repayment of note payable	-	(294 )
Repayment of notes payable due to related party	(190 )	-
Proceeds from issuance of preferred stock	-	150
Net cash provided by (used in) financing activities	153	(144 )
Effect of exchange rate differences on cash	10	-

NET INCREASE IN CASH AND CASH EQUIVALENTS	7,397	1,421
Cash and cash equivalents - beginning of period	2,294	3,101
Cash and cash equivalents - end of period	\$9,691	\$4,522
SUPPLEMENTAL DISCLOSURE OF CASH INFORMATION		
Interest paid	\$5	\$30
Income taxes paid	\$411	\$9
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES		
Inventories transferred to property and equipment, attributable to operating leases, net	\$8	\$93
Accrued preferred stock dividends	\$-	\$1,459
Common shares, warrants and contingent shares issued for acquisition	\$-	\$2,979
Fair value of assets acquired	\$291	\$4,469
Liabilities assumed through acquisition	\$(291)	\$(931)
Issuance of preferred stock in satisfaction of accrued dividend	\$-	\$224
Conversion of preferred stock to common stock	\$-	\$32
Common shares issued for consulting agreements	\$-	\$1,070

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



Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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. In 2010, we were primarily engaged in designing, manufacturing, marketing and supporting EECP® 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. In May 2010, the Company, through its wholly-owned subsidiary Vaso Diagnostics, Inc. d/b/a VasoHealthcare, expanded into the sales representation business via its agreement with GE Healthcare (“GEHC”), the healthcare business unit of General Electric Company (NYSE: GE), to be GEHC’s exclusive sales representative for the sale of select GEHC diagnostic imaging products in specific market segments in the 48 contiguous states of the United States and the District of Columbia. In June 2012, the Company entered into an amendment, effective July 1, 2012, of the sales representative agreement (“GEHC Agreement”) extending the initial term of three years commencing July 1, 2010 to five years through June 30, 2015, subject to earlier termination under certain circumstances.

In September 2011, the Company acquired Fast Growth Enterprises Limited (FGE), a British Virgin Islands company which, through its subsidiaries, owns and controls two Chinese operating companies - Life Enhancement Technologies Ltd. and Biox Instruments Co. Ltd., respectively – to expand its technical and manufacturing capabilities and to enhance its distribution network, technology, and product portfolio. Also in September 2011, the Company restructured to further align its business management structure and long-term growth strategy and now operates through three wholly-owned subsidiaries. Vaso Diagnostics d/b/a VasoHealthcare continues as the operating subsidiary for the sales representation of GE Healthcare diagnostic imaging products; Vasomedical Global Corp. operates the Company’s recently-acquired Chinese companies; and Vasomedical Solutions, Inc. manages and coordinates our EECP® therapy business as well as other medical equipment operations.

We report the operations of Vasomedical Global Corp. and Vasomedical Solutions, Inc. under our Equipment reportable segment. VasoHealthcare activities are included under our Sales Representation reportable segment (See Note C).

NOTE B - BASIS OF PRESENTATION AND CRITICAL ACCOUNTING POLICIES

Basis of Presentation and Use of Estimates

The accompanying consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and pursuant to the accounting and disclosure rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and disclosures normally included in the consolidated condensed financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these consolidated condensed financial statements should be read in connection with the audited consolidated financial statements and related notes thereto included in the Company’s Transition Report on Form 10-K for the transition period ended December 31, 2011, as filed with the SEC. These consolidated condensed financial statements include the accounts of the companies over which we exercise control. In the opinion of management, the accompanying consolidated condensed financial statements reflect all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of interim results for the Company. The results of operations for any interim period are not necessarily indicative of results to be expected for any other interim period or the full year.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated condensed financial statements, the disclosure of contingent assets and liabilities in the consolidated condensed financial statements and the accompanying notes, and the reported amounts of revenues, expenses and cash flows during the periods presented. Actual amounts and results could differ from those estimates. The estimates and assumptions the Company makes are based on historical factors, current circumstances and the experience and judgment of the Company's management. The Company evaluates its estimates and assumptions on an ongoing basis.

## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

## Significant Accounting Policies

Note B of the Notes to Consolidated Financial Statements, included in the Transition Report on Form 10-K for the seven months ended December 31, 2011, includes a summary of the significant accounting policies used in the preparation of the consolidated condensed financial statements.

## Revenue and Expense Recognition for VasoHealthcare

The Company recognizes commission revenue in its Sales Representation segment (see Note C) when persuasive evidence of an arrangement exists, service has been rendered, the price is fixed or determinable and collectability is reasonably assured. These conditions are deemed to be met when the underlying equipment has been accepted at the customer site in accordance with the specific terms of the sales agreement. Consequently, amounts billable under the agreement with GE Healthcare in advance of the customer acceptance of the equipment are recorded as accounts receivable and deferred revenue in the Consolidated Balance Sheets. Similarly, commissions payable to our sales force related to such billings are recorded as deferred commission expense when the associated deferred revenue is recorded. Commission expense is recognized when the corresponding commission revenue is recognized.

## Reclassifications

Certain reclassifications have been made to prior period amounts to conform with the current period presentation.

## NOTE C – SEGMENT REPORTING AND CONCENTRATIONS

The Company views its business in two segments – the Equipment segment and the Sales Representation segment. The Equipment segment is engaged in designing, manufacturing, marketing and supporting EECP® enhanced external counterpulsation systems both domestically and internationally, as well as the marketing of other medical devices. The Sales Representation segment operates through the VasoHealthcare subsidiary and is currently engaged solely in the execution of the Company’s responsibilities under our agreement with GEHC. The Company evaluates segment performance based on operating income. Administrative functions such as finance, human resources, and information technology are centralized and related expenses allocated to each segment. Other costs not directly attributable to operating segments, such as audit, legal, director fees, investor relations, and others, as well as certain assets – primarily cash balances – are reported in the Corporate entity below. There are no intersegment revenues. Summary financial information for the segments is set forth below:

	(in thousands)			
	As of or for the three months ended September 30, 2012			
	Sales			
	Equipment Segment	Representation Segment	Corporate	Consolidated
Revenues from external customers	\$1,063	\$ 4,659	\$-	\$ 5,722
Operating loss	\$(838 )	\$ (1,358 )	\$(463 )	\$ (2,659 )
Total assets	\$8,595	\$ 11,319	\$9,595	\$ 29,509
Accounts and other receivables, net	\$1,059	\$ 7,329	\$-	\$ 8,388
Deferred commission expense	\$-	\$ 3,635	\$-	\$ 3,635

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As of or for the three months ended September 30,  
2011

	Sales			Consolidated
	Equipment Segment	Representation Segment	Corporate	
Revenues from external customers	\$800	\$ 5,730	\$-	\$ 6,530
Operating income/(loss)	\$(640 )	\$ 1,047	\$(381 )	\$ 26
Total assets	\$8,810	\$ 12,405	\$4,318	\$ 25,533
Accounts and other receivables, net	\$763	\$ 9,260	\$-	\$ 10,023
Deferred commission expense	\$-	\$ 3,124	\$-	\$ 3,124

## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

	(in thousands)			
	As of or for the nine months ended September 30, 2012			
		Sales		
	Equipment Segment	Representation Segment	Corporate	Consolidated
Revenues from external customers	\$4,604	\$ 14,858	\$-	\$ 19,462
Operating loss	\$(1,191 )	\$ (1,473 )	\$(1,221 )	\$ (3,885 )
Total assets	\$8,595	\$ 11,319	\$9,595	\$ 29,509
Accounts and other receivables, net	\$1,059	\$ 7,329	\$-	\$ 8,388
Deferred commission expense	\$-	\$ 3,635	\$-	\$ 3,635
	As of or for the nine months ended September 30, 2011			
		Sales		
	Equipment Segment	Representation Segment	Corporate	Consolidated
Revenues from external customers	\$3,005	\$ 13,545	\$-	\$ 16,550
Operating income/(loss)	\$(1,382 )	\$ 628	\$(663 )	\$ (1,417 )
Total assets	\$8,810	\$ 12,405	\$4,318	\$ 25,533
Accounts and other receivables, net	\$763	\$ 9,260	\$-	\$ 10,023
Deferred commission expense	\$-	\$ 3,124	\$-	\$ 3,124

For the three months ended September 30, 2012 and 2011, GE Healthcare accounted for 81% and 88% of revenue, respectively. For the nine months ended September 30, 2012 and 2011, GE Healthcare accounted for 76% and 82% of revenue, respectively. Also, GE Healthcare accounted for \$7.2 million, or 86%, and \$19.7 million, or 95%, of accounts and other receivables at September 30, 2012 and December 31, 2011, respectively.

## NOTE D – SHARE-BASED COMPENSATION

The Company complies with ASC Topic 718 “Compensation – Stock Compensation” (“ASC 718”), which requires all share-based awards to employees, including grants of employee stock options, to be recognized in the consolidated condensed financial statements based on their estimated fair values.

During the three and nine-month periods ended September 30, 2012, the Company granted 0 and 500,000 restricted shares of common stock, valued at \$120,000 to an officer, of which half vested immediately and the remainder one year thereafter. During the three months ended September 30, 2011, 100,000 shares of restricted common stock valued at \$35,000 were granted to officers and directors, and 466,279 shares of restricted common stock valued at \$170,500 were granted to officers and directors during the nine months ended September 30, 2011.

During the nine-month periods ended September 30, 2012 and 2011, the Company did not grant any stock options.

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For the three and nine months ended September 30, 2012, the Company granted 500,000 and 2,690,000 shares of restricted common stock valued at \$130,000 and \$678,000 to non-officer employees in its VasoHealthcare subsidiary in conjunction with the extension of the GEHC Agreement in June 2012. For the three and nine months ended September 30, 2011, the Company granted 0 and 10,000 shares of restricted common stock, respectively, valued at \$6,800 to other non-officer employees.

## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Share-based compensation expense recognized for the three and nine months ended September 30, 2012 was \$328,000 and \$559,000, respectively, and \$92,000 and \$295,000 for the three and nine months ended September 30, 2011, respectively. These expenses are included in cost of revenues; selling, general, and administrative expenses; and research and development expenses in the consolidated condensed statements of operations. Expense for share-based arrangements was \$128,000 and \$416,000 for the three and nine months ended September 30, 2012, respectively, and \$159,000 and \$367,000 for the three and nine months ended September 30, 2011, respectively. Unrecognized expense related to existing share-based compensation and arrangements is approximately \$806,000 at September 30, 2012 and will be recognized through July 2013.

## NOTE E – LOSS PER COMMON SHARE

Basic loss per common share is computed as earnings applicable to common stockholders divided by the weighted-average number of common shares outstanding for the period. Diluted loss per common share reflects the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common stock.

The following table represents common stock equivalents that were excluded from the computation of diluted earnings per share for the three and nine months ended September 30, 2012 and 2011, because the effect of their inclusion would be anti-dilutive.

	(in thousands)			
	For the three months ended		For the nine months ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Stock options	1,810	1,810	1,810	1,810
Warrants	1,500	5,786	1,500	5,786
Contingently issuable shares	-	2,000	-	2,000
Common stock grants	3,260	2,903	3,260	2,903
	6,570	12,499	6,570	12,499

## NOTE F – FAIR VALUE MEASUREMENTS

The Company complies with the provisions of ASC 820 “Fair Value Measurements and Disclosures” (“ASC 820”). Under ASC 820, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the “exit price”) in an orderly transaction between market participants at the measurement date.

## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

The following tables present information about the Company's assets and liabilities measured at fair value as of September 30, 2012 and December 31, 2011:

	(in thousands)			
	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of September 30, 2012 (unaudited)
<b>Assets</b>				
Cash equivalents invested in money market funds (included in cash and cash equivalents)	\$8,604	\$-	\$ -	\$8,604
Investment in certificates of deposit (included in short-term investments)	110			110
	\$8,714	\$-	\$ -	\$8,714

	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2011
<b>Assets</b>				
Cash equivalents invested in money market funds (included in cash and cash equivalents)	\$1,313	\$-	\$ -	\$1,313
Investment in certificates of deposit (included in short-term investments)	110			110
	\$1,423	\$-	\$ -	\$1,423

The fair values of the Company's cash equivalents invested in money market funds are determined through market, observable and corroborated sources.

## NOTE G – ACCOUNTS AND OTHER RECEIVABLES, NET

The following table presents information regarding the Company's accounts and other receivables as of September 30, 2012 and December 31, 2011:

	(in thousands)	
	September 30, 2012	December 31, 2011
		(unaudited)



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Trade receivables	\$10,349	\$22,737
Due from employees	125	121
Allowance for doubtful accounts and commission adjustments	(2,086 )	(2,163 )
Accounts and other receivables, net	\$8,388	\$20,695

Trade receivables include amounts due for shipped products and services rendered. Amounts currently due under the GEHC Agreement are subject to adjustment in subsequent periods should the underlying sales order amount, upon which the receivable is based, change.

## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Allowance for doubtful accounts and commission adjustments include estimated losses resulting from the inability of our customers to make required payments, and adjustments arising from subsequent changes in sales order amounts that may reduce the amount the Company will ultimately receive under the GEHC Agreement. Due from employees is primarily commission advances made to sales personnel.

## NOTE H – INVENTORIES, NET

Inventories, net of reserves, consist of the following:

	(in thousands)	
	September 30, 2012	December 31, 2011
	(unaudited)	
Raw materials	\$1,087	\$842
Work in process	521	528
Finished goods	853	1,051
	\$2,461	\$2,421

At September 30, 2012 and December 31, 2011, the Company had reserves for excess and obsolete inventory of \$540,000 and \$606,000, respectively.

## NOTE I – BUSINESS COMBINATION

On September 2, 2011, Vasomedical Global successfully completed the purchase of all the outstanding capital stock of privately-held Fast Growth Enterprises Limited (“FGE”), a British Virgin Islands company that owns subsidiaries which own and control Life Enhancement Technology Ltd (“LET”) and Biox Instruments Co. Ltd. (“Biox”), respectively, as per the stock purchase agreement signed on August 19, 2011. The consideration of this acquisition included a cash payment of \$1 million as well as the issuance of 5 million restricted shares of the Company’s common stock, up to 2.4 million shares of common stock contingently issuable upon the achievement of certain operating performance targets, and warrants covering 1.5 million shares of common stock. The Company completed its evaluation of FGE’s calendar year 2011 performance targets and determined that the targets were met, resulting in the issuance of 2.4 million shares to the prior owners in September 2012.

LET, based in Foshan, Guangdong, China, is Vasomedical’s supplier for its proprietary Enhanced External Counterpulsation (EECP®) systems, including certain Lumenair systems and all AngioNew® systems. Biox, a developer and manufacturer of ambulatory monitoring devices, is located in Wuxi, Jiangsu, China, and is Vasomedical’s supplier of the BIOX series ECG Holter recorder and analysis software as well as ambulatory blood pressure monitoring systems. Vasomedical has obtained FDA clearance to market these products in the United States. The acquisition of LET provides Vasomedical with consolidated technical and manufacturing capability in its EECP business which has significantly increased gross margins and will enable the Company to meet anticipated increasing demand for its EECP systems. The acquisition of Biox greatly enhances Vasomedical's distribution network, technology and product portfolio, and with combined market and sales efforts of the two companies, has improved performance and profitability of Vasomedical's equipment segment.

The operating results of FGE are included in the accompanying Consolidated Condensed Statements of Operations and Comprehensive Income (Loss) and Cash Flows for the three and nine months ended September 30, 2012. The

acquisition date fair value of the total consideration transferred was \$3.979 million, which consisted of the following:

## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

	(in thousands)
Cash	\$1,000
Vasomedical, Inc. common stock (\$0.42 per share)	2,100
Vasomedical, Inc. warrants to purchase common stock	304
Contingent issuance of Vasomedical, Inc. common stock (\$0.42 per share)	575
Total purchase price	\$3,979

In accordance with Accounting Standards Codification ("ASC") 805, Business Combinations ("ASC 805"), the total purchase consideration is allocated to the net tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of September 2, 2011 (the acquisition date). The purchase price was allocated based on the information available as of the acquisition date, and subsequently adjusted (measurement period adjustments) after obtaining more information regarding, among other things, asset valuations, liabilities assumed, and revisions of preliminary estimates. The measurement period adjustments were completed during the quarter ended September 30, 2012 (within a year of the acquisition date). The accompanying Consolidated Condensed Balance Sheet as of December 31, 2011 has been retroactively adjusted to include the effect of the measurement period adjustment. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date:

	(in thousands)		
	As initially reported	Measurement period adjustments	As adjusted
Cash and cash equivalents	\$442	\$ -	\$442
Accounts receivable and other current assets	591	(308 )	283
Inventories	670	(194 )	476
Property and equipment	32	-	32
Goodwill	3,175	(7 )	3,168
Customer lists	-	800	800
Accounts payable and other current liabilities	(931 )	(291 )	(1,222 )
Net assets acquired	\$3,979	\$ -	\$3,979

The goodwill is attributable to the synergies expected to arise after the Company's acquisition of FGE as well as FGE's projected growth and profitability. The goodwill is not expected to be deductible for tax purposes. Customer lists were valued based on sales history of certain recurring customers and the timing of expected future revenues.

After elimination of intercompany transactions, which reduce the income from FGE, the amounts of revenue and net loss of FGE included in the Company's Consolidated Condensed Statement of Operations and Comprehensive Loss for the three months ended September 30, 2012 was \$271,000 and \$189,000, respectively, and \$1,181,000 and \$299,000, respectively, for the nine months ended September 30, 2012. For the three and nine months ended September 30, 2011, the amounts of revenue and net loss of FGE included in the Company's Consolidated Condensed Statement of Operations and Comprehensive Income (Loss) were \$96,000 and \$24,000, respectively. The effect of FGE's loss on earnings per share for the three and nine months ended September 30, 2012 and September 30, 2011 was \$0.00.

The following supplemental pro forma information presents the financial results as if the acquisition of FGE had occurred June 1, 2009 (amounts in thousands, except per share amounts):

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(in thousands except per share data)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Revenue	\$5,722	\$6,605	\$19,462	\$17,225
Net (loss) income	(2,515 )	19	(3,620 )	(937 )
Basic and diluted (loss) earnings per share	\$(0.02 )	\$(0.01 )	\$(0.02 )	\$(0.02 )

Page 12

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## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

## NOTE J – GOODWILL AND OTHER INTANGIBLES

Goodwill aggregating \$3,200,000 and \$3,168,000 (retroactively adjusted to give effect to measurement period adjustment) was recorded on the Company's Consolidated Condensed Balance Sheets at September 30, 2012 and December 31, 2011, respectively, pursuant to the acquisition of FGE in September 2011. All of the goodwill was allocated to the Company's Equipment segment. The components of the change in goodwill are as follows:

	Carrying Amount
Balance at December 31, 2011	\$3,168
Foreign currency translation	32
Balance at September 30, 2012	\$3,200

The Company's other intangible assets consist of capitalized customer lists and patent costs, as follows:

	(in thousands)	
	September 30, 2012	December 31, 2011 (a)
Other intangibles, net	(unaudited)	
Customer lists, net	\$676	\$800
Patents, net	37	56
	\$713	\$856

(a) Retroactively adjusted to give effect to measurement period adjustment.

Patents and customer lists are included in other assets in the accompanying Consolidated Condensed Balance Sheets and customer lists are amortized on a straight line basis over their estimated useful life of seven years. The useful life was estimated based on the length of time the customer is expected to remain active. Amortization expense amounted to \$130,000 and \$9,000 for the three months ended September 30, 2012 and 2011, respectively, and \$143,000 and \$28,000 for the nine months ended September 30, 2012 and 2011, respectively.

## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

## NOTE K - DEFERRED REVENUE

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

	(in thousands)			
	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Deferred revenue at the beginning of the period	\$ 15,198	\$ 11,360	\$ 15,228	\$ 12,637
Additions:				
Deferred extended service contracts	288	240	987	968
Deferred in-service and training	13	10	33	28
Deferred service arrangements	20	20	75	65
Deferred commission revenues	2,037	4,941	6,116	9,085
Recognized as revenue:				
Deferred extended service contracts	(283 )	(269 )	(840 )	(872 )
Deferred in-service and training	(10 )	(8 )	(25 )	(23 )
Deferred service arrangements	(22 )	(21 )	(64 )	(55 )
Deferred commission revenues	(2,243 )	(2,798 )	(6,512 )	(8,358 )
Deferred revenue at end of period	14,998	13,475	14,998	13,475
Less: current portion	10,102	10,042	10,102	10,042
Long-term deferred revenue at end of period	\$ 4,896	\$ 3,433	\$ 4,896	\$ 3,433

## NOTE L – RELATED-PARTY TRANSACTIONS

On June 21, 2007, we entered into a Securities Purchase Agreement with Kerns Manufacturing Corp. (“Kerns”). Pursuant to this agreement, a five-year warrant to purchase 4,285,714 shares of our common stock at an initial exercise price of \$0.08 per share was issued to Kerns. In March 2012, Kerns exercised its warrant and purchased 4,285,714 shares of common stock. 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. Pursuant to the Distribution Agreement, as amended, we became the exclusive worldwide distributor of the AngioNew EECF® systems manufactured through Living Data. The Distribution Agreement had an initial term extending through May 31, 2012. Subsequent to August 31, 2011 the Company acquired Life Enhancement Technology (LET) (see Note I), the manufacturer of the AngioNew EECF® system. Consequently, the Distribution Agreement is no longer effective, and the Company wrote-off the remaining unamortized balance of Deferred Distributor Costs during the seven months ended December 31, 2011.

On February 28, 2011, David Lieberman and Edgar Rios were appointed by the Board of Directors as directors of the Company. Mr. Lieberman, a practicing attorney in the State of New York, was appointed to serve as the Vice Chairman of the Board. He is currently a senior partner at the law firm of Beckman, Lieberman & Barandes, LLP, which firm performs certain legal services for the Company. Fees of approximately \$30,000 and \$102,000 were billed by the firm through the three and nine months ended September 30, 2011, respectively, and approximately \$60,000 and \$194,000 were billed by the firm through the three and nine months ended September 30, 2012, respectively, at which date no amounts were outstanding.

Mr. Rios is President of Edgery Consultants, LLC, and was appointed a director in conjunction with the Company's consulting agreement (the "Agreement") with Edgery Consultants, LLC ("Consultant"). The Agreement commenced on March 1, 2011 and runs for a two year term. The Agreement provides for the engagement of Consultant to assist the Company in seeking broader reimbursement coverage of EEC<sup>®</sup> therapy. More specifically, Consultant will be assisting the Company in the following areas:



Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

1. Engaging the adoption of EECP® therapy as a first line option for FDA cleared indications as it relates to CCS Class III/IV angina with a major commercial healthcare third-party payer.
2. Engaging a major commercial healthcare payer to formally collaborate and co-sponsor a study with Vasomedical for the efficacy, efficiency and/or cost effectiveness of the EECP® therapy for NYHA Class II/III heart failure.
  3. Engaging final approval from the Centers for Medicare and Medicaid Services (“CMS”) of EECP® therapy as a first line treatment for CCS Class III/IV angina.
4. Engaging final approval from CMS to extend coverage and provide for the reimbursement of EECP® therapy for CCS Class II angina; and
5. Engaging final approval from CMS to extend coverage and provide for the reimbursement of EECP® therapy for NYHA Class II/III heart failure.

In consideration for the services to be provided by Consultant under the Agreement, the Company has agreed to issue to Consultant or its designees, approximately 10% of the outstanding capital stock of the Company, of which the substantial portion (in excess of 82%) is performance based as referenced above. In conjunction with the Agreement, 3,000,000 shares of restricted common stock valued at \$1,020,000 were issued in March 2011. In connection with the Agreement, Mr. Lieberman received 600,000 of these restricted shares. The Company has recorded the fair value of the shares issued to Consultant as a prepaid expense and is amortizing the cost ratably over the two year agreement. The unamortized value is reported as Deferred Related Party Consulting Expense in our accompanying consolidated condensed balance sheets as of September 30, 2012 and December 31, 2011.

During the nine months ended September 30, 2012, a director performed consulting services for the Company aggregating approximately \$10,000.

Through the Company’s acquisition of FGE in September 2011, it assumed the liability for \$288,000 in unsecured notes payable to the President of LET and his spouse, of which \$95,000 was repaid in December 2011, and \$190,000, bearing interest at 6% per annum, was paid in March 2012. In addition, receivables due from FGE management aggregating \$159,000 were collected during the nine months ended September 30, 2012.

#### NOTE M – STOCKHOLDERS’ EQUITY

##### Common Stock

On June 17, 2010 the Board of Directors approved the 2010 Stock Plan (the “2010 Plan”) for officers, directors, employees and consultants of the Company. The stock issuable under the 2010 Plan shall be shares of the Company’s authorized but unissued or reacquired common stock. The maximum number of shares of common stock which may be issued under the 2010 Plan is 5,000,000 shares.

The 2010 Plan is comprised of two separate equity programs, the Options Grant Program, under which eligible persons may be granted options to purchase shares of common stock, and the Stock Issuance Program, under which eligible persons may be issued shares of common stock directly, either through the immediate purchase of such shares or as compensation for services rendered to the Company.

The 2010 Plan provides that the Board of Directors, or a committee of the Board of Directors, will administer it with full authority to determine the identity of the recipients of the options or shares and the number of options or shares. Options granted under the 2010 Plan may be either incentive stock options or non-qualified stock options. The option price shall be 100% of the fair market value of the common stock on the date of the grant ( or in

the case of incentive stock options granted to any individual stockholder possessing more than 10% of the total combined voting power of all voting stock of the Company, 110% of such fair market value). The term of any option may be fixed by the Board of Directors, or its authorized committee, but in no event shall it exceed five years from the date of grant. Options are exercisable upon payment in full of the exercise price, either in cash or in common stock valued at fair market value on the date of exercise of the option.

As of September 30, 2012, 3,790,000 restricted shares of common stock were granted under the 2010 Plan to non-officer employees and consultants of the Company. As of September 30, 2012, 840,000 shares have been forfeited. In March 2012, 500,000 restricted shares of common stock were granted under the 2010 Plan to an officer, of which 250,000 vested immediately with the remainder vesting over a one year period. In June 2012, 2,190,000 additional shares, vesting at various times through July 1, 2013, of restricted common stock were granted to non-officer employees in conjunction with the extension of the GEHC Agreement, of which 185,500 shares had been forfeited as of September 30, 2012. In July 2012, 500,000 shares of restricted common stock were granted to non-officer employees, of which 250,000 vest in June 2013 and the remainder in June 2014.

Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

No options were issued under the 2010 Plan during the nine months ended September 30, 2012 and 2011.

In September 2011, the Company issued 5,000,000 shares of restricted common stock and a two year common stock purchase warrant for 1,500,000 shares at an exercise price of \$0.50 per share as partial consideration for the acquisition of FGE. In addition, 2,400,000 shares of common stock were issued, under the terms of the purchase agreement, in September 2012 to former owners of FGE for attaining certain operating targets for the twelve months ending December 31, 2011. The aggregate value of the aforementioned noncash consideration relative to the FGE acquisition, recorded as of the September 2, 2011 acquisition date, was \$2,979,000 (see Note I).

Preferred Stock

On June 24, 2010, the Company filed a Certificate of Designations of Preferences and Rights of Series E Convertible Preferred Stock (“Certificate of Designations”), as authorized by the Board of Directors, designating 350,000 shares of its 1,000,000 shares of preferred stock as Series E Convertible Preferred Stock (“Series E Preferred”). The conversion rights of the Series E Preferred are that each share will be convertible at any time on or after January 1, 2011, at the holder’s option into 100 shares of common stock (an exercise price of \$.16 per share of common stock, the “Conversion Price”), subject to anti-dilution adjustment as set forth below. Each share of outstanding Series E Preferred Stock shall automatically be converted into shares of common stock on or after July 1, 2011, at the then effective applicable conversion ratio, if, at any time following the Issuance Date, the price of the common stock for any 30 consecutive trading days equals or exceeds three times the Conversion Price and the average daily trading volume for the Company’s common stock for the 30 consecutive trading days exceeds 250,000 shares.

Pursuant to its conversion terms, the Series E Preferred was deemed automatically converted to common stock effective July 1, 2011. As of September 30, 2012, 30,668,500 shares of common stock had been issued for 306,685 shares of Series E Preferred.

For the three and nine months ended September 30, 2011, the Company sold 0 and 9,375 shares of Series E Preferred aggregating \$150,000, and recorded dividends totaling \$1,180,000 and \$1,459,000, respectively. Included in such dividends is the recognition of the value of the embedded beneficial conversion feature of the Series E Preferred, which reflects the difference between the conversion price and the market price at time of investment. The amounts included in the dividends reported attributable to this beneficial conversion feature are \$1,180,000 and \$1,336,000 for the three and nine months ended September 30, 2011, respectively. These are noncash dividends requiring no payment and ceased on conversion of the Series E Preferred to common stock.

NOTE N – COMMITMENTS AND CONTINGENCIES

Sales representation agreement

In June 2012, the Company concluded an amendment of the GEHC Agreement with GE Healthcare, originally signed on May 19, 2010. The amendment, effective July 1, 2012, extends the initial term of three years commencing July 1, 2010 to five years through June 30, 2015, subject to earlier termination under certain circumstances. These circumstances include not materially achieving certain sales goals, not maintaining a minimum number of sales representatives, and various legal and GEHC policy requirements. Under the terms of the agreement, the Company is required to lease dedicated computer equipment from GEHC for connectivity to their network.

In conjunction with the extension of the GEHC Agreement, the Company granted VasoHealthcare employees both stock and cash-based performance incentives for the ensuing year. The incentives provide for cash payments of up to \$2.2 million and 2.2 million shares of restricted common stock grants and vest at various times through July 1, 2013. A condition of the incentives is that the employees remain continuously employed through the vesting dates. As of September 30, 2012, approximately \$1.3 million and 1.3 million shares remain unvested.

Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE O - RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Other Comprehensive Income: Presentation of Comprehensive Income

In June 2011, new guidance was issued that amends the current comprehensive income guidance. The new guidance allows the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single or continuous statement of comprehensive income or in two separate but consecutive statements. The amendments in this update do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The new guidance is to be applied retrospectively and is effective for fiscal years, and interim periods, beginning after December 15, 2011, with early adoption permitted. The adoption of this guidance did not have a material impact on the Company's consolidated condensed financial statements.

In December 2011, the FASB issued authoritative guidance to defer the effective date for those aspects of the guidance relating to the presentation of reclassification adjustments out of accumulated other comprehensive income. The adoption of this new guidance will not have an impact on the Company's consolidated financial position, results of operations or cash flows as it only requires a change in the format of the current presentation of other comprehensive income.

Vasomedical, Inc. and Subsidiaries

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; continuation of the GEHC Agreement and the risk factors reported from time to time in the Company’s SEC reports, including its recent transition report on Form 10-K. 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. In 2010, we were primarily engaged in designing, manufacturing, marketing and supporting EECP® Enhanced External Counterpulsation systems, based on our proprietary technology, to physicians and hospitals throughout the United States and in select international markets.

In May 2010, the Company, through its wholly-owned subsidiary Vaso Diagnostics, Inc. d/b/a VasoHealthcare, expanded into the sales representation business via its agreement with GE Healthcare (“GEHC”), the healthcare business unit of General Electric Company (NYSE: GE), to be GEHC’s exclusive sales representative for the sale of select GEHC diagnostic imaging products in specific market segments in the 48 contiguous states of the United States and the District of Columbia. In June 2012, the Company entered into an amendment, effective July 1, 2012, of the sales representative agreement (“GEHC Agreement”) extending the initial term of three years commencing July 1, 2010 to five years through June 30, 2015, subject to earlier termination under certain circumstances.

In September 2011, the Company acquired Fast Growth Enterprises Limited (FGE), a British Virgin Islands company, which, through its subsidiaries, owns and controls two Chinese operating companies - Life Enhancement Technology Ltd. and Biox Instruments Co. Ltd., respectively - to expand its technical and manufacturing capabilities and to enhance its distribution network, technology, and product portfolio. Also in September 2011, the Company restructured to further align its business management structure and long-term growth strategy, and now operates through three wholly-owned subsidiaries. Vaso Diagnostics d/b/a VasoHealthcare continues as the operating subsidiary for the sales representation of GE diagnostic imaging products; Vasomedical Global Corp. operates the Company’s newly-acquired Chinese companies; and Vasomedical Solutions, Inc. was formed to manage and coordinate our EECP® therapy business as well as other medical equipment operations.

We now report the operations of Vasomedical Global Corp. and Vasomedical Solutions, Inc. under our Equipment reportable segment. VasoHealthcare activities are included under our Sales Representation reportable segment (see Note C).

The Company will seek to improve profitability through our recent accretive acquisition of the two Chinese medical device companies and by expanding our U.S. market product portfolio. In addition, the Company plans to actively pursue other accretive acquisitions.

Vasomedical, Inc. and Subsidiaries

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon the accompanying unaudited consolidated condensed financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”). The preparation of financial statements in conformity with U.S. GAAP requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses, and the related disclosures at the date of the financial statements and during the reporting period. Although these estimates are based on our knowledge of current events, our actual amounts and results could differ from those estimates. The estimates made are based on historical factors, current circumstances, and the experience and judgment of our management, who continually evaluate the judgments, estimates and assumptions and may employ outside experts to assist in the evaluations.

Certain of our accounting policies are deemed “critical”, as they are both most important to the financial statement presentation and require management’s most difficult, subjective or complex judgments as a result of the need to make estimates about the effect of matters that are inherently uncertain. For a discussion of our critical accounting policies, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Transition Report on Form 10-K for the seven months ended December 31, 2011.

On June 15, 2011, the Board of Directors approved a change of the Company’s fiscal year end from May 31st to December 31st. As a result of this change, the Company filed a Transition Report on Form 10-K for the seven-month transition period ended December 31, 2011. Going forward, references to our 2012 and 2011 fiscal years herein mean the fiscal years ended December 31, 2012 and December 31, 2011, respectively.

New Accounting Pronouncements - Adoption of New Standards

Other Comprehensive Income: Presentation of Comprehensive Income

In June 2011, new guidance was issued that amends the current comprehensive income guidance. The new guidance allows the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single or continuous statement of comprehensive income or in two separate but consecutive statements. The amendments in this update do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The new guidance is to be applied retrospectively and is effective for fiscal years, and interim periods, beginning after December 15, 2011, with early adoption permitted. The adoption of this guidance did not have a material impact on the Company’s consolidated financial statements.

In December 2011, the FASB issued authoritative guidance to defer the effective date for those aspects of the guidance relating to the presentation of reclassification adjustments out of accumulated other comprehensive income. The adoption of this new guidance will not have an impact on the Company’s consolidated financial position, results of operations or cash flows as it only requires a change in the format of the current presentation of other comprehensive income.

Consolidated Results of Operations

Three months ended September 30, 2012 and September 30, 2011

Total revenue for the three months ended September 30, 2012 and September 30, 2011, was \$5,722,000 and \$6,530,000, respectively, a decrease of \$808,000, or 12%. Net loss for the three months ended September 30, 2012 was \$2,518,000 compared to net income of \$64,000 for the three months ended September 30, 2011. We a reported



net loss applicable to common stockholders of \$2,518,000 for the third quarter of fiscal year 2012 compared to a net loss applicable to common stockholders of \$1,116,000 for the third quarter of fiscal year 2011. The increase in net loss applicable to common stockholders was primarily attributable to a \$2,038,000 increase in selling, general and administrative (“SG&A”) costs (of which \$1,557,000 was attributable to the Sales Representation segment), partially offset by a \$1,180,000 decrease in preferred stock dividends. Our total net loss was (\$0.02) and (\$0.01) per basic and diluted common share for the three months ended September 30, 2012 and 2011, respectively.

Vasomedical, Inc. and Subsidiaries

Revenues

Revenue in our Equipment segment increased by \$263,000, or 33%, to \$1,063,000 for the three-month period ended September 30, 2012 from \$800,000 for the same period of the prior year. Equipment segment revenue from equipment sales increased by \$278,000, or 68%, to \$688,000 for the three-month period ended September 30, 2012 as compared to \$410,000 for the same period in the prior year. The increase in equipment sales is due to an increase of \$175,000 in equipment sales generated by our Chinese subsidiaries acquired in September 2011 and an increase in the sales price per EECP® unit, partially offset by decreases in the number of EECP® and other medical equipment units shipped.

Current demand for EECP® systems will likely remain soft until there is greater clinical acceptance for the use of EECP® therapy in treating patients with angina or angina equivalent symptoms who meet the current reimbursement guidelines, or a favorable change in current reimbursement policies by CMS or third party payers to consider EECP therapy as a first-line treatment option for angina or cover 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. As described in Note L, we are pursuing initiatives to expand reimbursement that we expect should ultimately increase overall market demand for our EECP® systems.

Equipment segment revenue from equipment rental and services decreased 4% to \$375,000 in the third quarter of 2012 from \$390,000 in the third quarter of 2011. Revenue from equipment rental and services represented 35% and 49% of total Equipment segment revenue in the third quarters of fiscal 2012 and fiscal 2011, respectively. The decrease in revenue generated from equipment rentals and services is due primarily to decreased accessory part revenue.

Commission revenues in the Sales Representation segment were \$4,659,000 in the third quarter of 2012, as compared to \$5,730,000 in the third quarter of 2011, a decrease of 19%. The decrease in commission revenue in the third quarter of 2012 is due to a 15% decrease in volume of equipment delivered by GEHC. In addition, third quarter 2011 revenue also exceeded third quarter 2012 revenue because a retroactive commission rate adjustment recorded in the third quarter of 2011 was, due to a change in contract terms which allowed us to recognize a higher commission rate earlier, recorded in the second quarter in 2012. The Company recognizes revenue when the underlying equipment has been accepted at the customer site in accordance with the specific terms of the sales agreement. Consequently, amounts billable under the agreement with GE Healthcare prior to customer acceptance of the equipment are recorded as deferred revenue in the Consolidated Condensed Balance Sheet. Due to the nature of our commission structure under the GEHC Agreement, wherein the Company earns progressively higher commission rates retroactively as calendar year targets are met, revenues earned in the first and fourth quarters typically reflect a higher blended commission rate than revenues earned in the second and third quarters. As of September 30, 2012, \$13,689,000 in deferred commission revenue was recorded in the Company's consolidated condensed balance sheet, of which \$4,378,000 is long-term. At September 30, 2011, \$12,417,000 in deferred commission revenue was recorded in the Company's consolidated condensed balance sheet, of which \$3,106,000 was long-term.

Gross Profit

The Company had a gross profit of \$4,063,000 in the third quarter of 2012 compared to \$4,719,000 in the third quarter of the prior year, a decrease of 14%. The decrease is principally due to the decrease in commission revenue discussed below. Equipment segment gross profit increased to \$633,000, or 60% of Equipment segment revenues, for the third quarter of 2012 compared to \$443,000 or 55% of Equipment segment revenues, for the same quarter of 2011. Equipment segment gross profit was favorably impacted both in absolute dollars and gross profit percentage by

the \$271,000 in sales of other medical equipment sold through our Chinese subsidiaries in the third quarter of 2012. In addition, gross profit on EECP® equipment improved due to lower costs arising from the acquisition of LET, our primary supplier of certain EECP® systems. Gross profit in the Equipment segment is dependent on a number of factors, particularly the mix of new and refurbished EECP® systems and the mix of models sold, their respective average selling prices, the mix of EECP® units sold, rented or placed during the period, the ongoing costs of servicing EECP® systems, and certain fixed period costs, including facilities, payroll and insurance.

Sales Representation segment gross profit was \$3,430,000, or 74%, for the three months ended September 30, 2012 as compared to \$4,276,000, or 75%, for the three months ended September 30, 2011. The decrease was due to lower revenue in this segment, as explained above. Cost of commissions of \$1,229,000 and \$1,454,000, for the three months ended September 30, 2012 and 2011, respectively, reflects commission expense associated with recognized commission revenues. Commission expense associated with deferred revenue is recorded as deferred commission expense until the related commission revenue is earned.

Vasomedical, Inc. and Subsidiaries

Operating Income (Loss)

Operating income (loss) was \$(2,659,000) for the three months ended September 30, 2012 as compared to operating income (loss) of \$26,000 for the three months ended September 30, 2011, a decrease of \$2,685,000. The increase in operating loss was primarily attributable to lower operating performance in the Sales Representation segment, where operating loss was \$1,358,000 for the third quarter of 2012 compared to operating income of \$1,047,000 in the same quarter of the prior year.

Selling, general and administrative (“SG&A”) expenses for the third quarter of 2012 and 2011 were \$6,591,000, or 115% of revenues, and \$4,553,000, or 70% of revenues, respectively, reflecting an increase of \$2,038,000 or approximately 45%. The increase in SG&A expenditures in the third quarter of 2012 resulted primarily from increased sales costs in the Sales Representation segment associated with the extension of the GEHC contract (see Note N), as well as increased sales, marketing and amortization costs in the Equipment segment which now includes SG&A costs - including a one-time charge of \$300,000 in incentive compensation for certain key employees - of the recently acquired Chinese entities, and higher corporate compensation costs.

Research and development (“R&D”) expenses of \$131,000, or 2% of revenues (12% of Equipment segment revenues), for the third quarter of 2012 decreased by \$9,000, or 6%, from \$140,000, or 2% of revenues (18% of Equipment segment revenues), for the third quarter of 2011. The decrease is primarily attributable to a decrease in clinical research expenses.

Interest and Financing Costs

No interest and financing costs were incurred in the third quarter of 2012, as compared to \$3,000 incurred in the third quarter of 2011. Interest and financing costs for the third quarter of 2011 consisted mainly of interest on related party trade payables.

Interest and Other Income, Net

Interest and other income for the third quarters of 2012 and 2011, was \$93,000 and \$33,000, respectively. The increase of \$60,000 in the third quarter of 2012 is due primarily to value-added tax refunds recognized by our Chinese subsidiaries, as well as to higher interest earned on the Company’s cash balances.

Amortization of Deferred Gain on Sale-leaseback of Building

The amortization of the deferred gain on the sale-leaseback of our Westbury, NY facility for the third quarters of 2012 and 2011 was \$4,000 and \$13,000, respectively. The deferred gain was fully amortized in the third quarter of 2012.

Income Tax Expense, Net

During the third quarter of year 2012 we recorded an income tax benefit of \$44,000 as compared to a provision of \$5,000 for the third quarter of 2011. The benefit arose from pre-tax losses at our Chinese subsidiaries.

Nine months ended September 30, 2012 and September 30, 2011

Total revenue for the nine months ended September 30, 2012 and September 30, 2011, was \$19,462,000 and \$16,549,000, respectively, an increase of \$2,913,000, or 18%. Net loss for the nine months ended September 30, 2012 was \$3,806,000 compared to a net loss of \$1,358,000 for the nine months ended September 30, 2011. We reported net loss applicable to common stockholders of \$3,806,000 for the first three quarters of 2012 compared to a net loss

applicable to common stockholders of \$2,817,000 for the first three quarters of 2011. The increase in net loss applicable to common stockholders was primarily attributable to a \$4,759,000 increase in selling, general and administrative (“SG&A”) costs (of which \$3,231,000 was attributable to the Sales Representation segment), partially offset by \$2,312,000 increase in gross profit and \$1,459,000 reduction in preferred stock dividends. Our total net loss was \$0.02 per basic and diluted common share for the nine months ended September 30, 2012 and 2011.

## Vasomedical, Inc. and Subsidiaries

## Revenues

Revenue in our Equipment segment increased by \$1,600,000, or 53%, to \$4,604,000 for the nine-month period ended September 30, 2012 from \$3,004,000 for the same period of the prior year. Equipment segment revenue from equipment sales increased by \$1,702,000, or 114%, to \$3,197,000 for the nine-month period ended September 30, 2012 as compared to \$1,495,000 for the same period in the prior year. The increase in equipment sales is due primarily to an increase of \$1,085,000 in equipment sales generated by our Chinese subsidiaries and an increase in the number of EECPC® units shipped as well as an increase in the sales price per EECPC® unit, partially offset by a decrease in sales of other medical equipment.

Current demand for EECPC® systems will likely remain soft until there is greater clinical acceptance for the use of EECPC® therapy in treating patients with angina or angina equivalent symptoms who meet the current reimbursement guidelines, or a favorable change in current reimbursement policies by CMS or third party payers to consider EECPC therapy as a first-line treatment option for angina or cover 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. As described in Note L, we are pursuing initiatives to expand reimbursement that we expect should ultimately increase overall market demand for our EECPC® systems.

Equipment segment revenue from equipment rental and services decreased 7% to \$1,407,000 in the first nine months of 2012 from \$1,509,000 in the first nine months of 2011. Revenue from equipment rental and services represented 31% and 50% of total Equipment segment revenue in the first nine months of 2012 and 2011, respectively. The decrease in revenue generated from equipment rentals and services is due primarily to decreased service revenue and lower accessory shipments.

Commission revenues in the Sales Representation segment were \$14,858,000 in the first nine months of 2012, as compared to \$13,545,000 in the first nine months of 2011, an increase of 10%. The increase in commission revenue in the first nine months of 2012 is due to increased volume of equipment delivered. The Company recognizes revenue when the underlying equipment has been accepted at the customer site in accordance with the specific terms of the sales agreement. Consequently, amounts billable under the agreement with GE Healthcare prior to customer acceptance of the equipment are recorded as deferred revenue in the Consolidated Condensed Balance Sheet. Due to the nature of our commission structure under the GEHC Agreement, wherein the Company earns progressively higher commission rates retroactively as calendar year targets are met, revenues earned in the first and fourth fiscal quarters typically reflect a higher blended commission rate than revenues earned in the second and third fiscal quarters. As of September 30, 2012, \$13,689,000 in deferred commission revenue was recorded in the Company's consolidated condensed balance sheet, of which \$4,378,000 is long-term. At September 30, 2011, \$12,417,000 in deferred commission revenue was recorded in the Company's consolidated condensed balance sheet, of which \$3,106,000 was long-term.

## Gross Profit

The Company had a gross profit of \$13,774,000 in the first nine months of 2012 compared to \$11,462,000 in the first nine months of the prior year, an increase of 20%. Equipment segment gross profit increased to \$2,601,000, or 56% of Equipment segment revenues, for the first nine months of 2012 compared to \$1,420,000 or 47% of Equipment segment revenues, for the first nine months of 2011. Equipment segment gross profit was favorably impacted both in absolute dollars and gross profit percentage by the \$1,181,000 in sales of other medical equipment sold through our Chinese subsidiaries in the first nine months of 2012. In addition, gross profit on EECPC® equipment improved due to lower costs arising from the acquisition of LET, our primary supplier of certain EECPC® systems. Gross profit in the Equipment segment is dependent on a number of factors, particularly the mix of new and refurbished EECPC® systems

and the mix of models sold, their respective average selling prices, the mix of EECP® units sold, rented or placed during the period, the ongoing costs of servicing EECP® systems, and certain fixed period costs, including facilities, payroll and insurance.

Sales Representation segment gross profit was \$11,173,000 for the nine months ended September 30, 2012 as compared to \$10,042,000 for the nine months ended September 30, 2011. Cost of commissions of \$3,685,000 and \$3,503,000, for the nine months ended September 30, 2012 and 2011, respectively, reflects commission expense associated with recognized commission revenues. Commission expense associated with deferred revenue is recorded as deferred commission expense until the related commission revenue is earned.

Vasomedical, Inc. and Subsidiaries

Operating Loss

Operating loss increased by \$2,468,000, or 174%, to \$3,885,000 for the nine months ended September 30, 2012 as compared to an operating loss of \$1,417,000 for the nine months ended September 30, 2011. The increase in operating loss was primarily attributable to lower operating performance in the Sales Representation segment, where operating loss was \$1,473,000 for the first nine months of 2012 compared to operating income of \$628,000 in the same period of 2011. The decreased operating performance in the Sales Representation segment was driven mainly by \$3,231,000 higher SG&A costs, partially offset by \$1,131,000 higher gross profit.

Selling, general and administrative (“SG&A”) expenses for the first nine months of 2012 and 2011 were \$17,256,000, or 89% of revenues, and \$12,497,000, or 76% of revenues, respectively, reflecting an increase of \$4,759,000 or approximately 38%. The increase in SG&A expenditures in the first nine months of 2012 resulted primarily from increased sales costs in the Sales Representation segment associated with the extension of the GEHC contract, as well as increased sales, marketing and amortization costs in the Equipment segment which now includes SG&A costs - including a one-time charge of \$300,000 in incentive compensation for certain key employees - of the recently acquired Chinese entities, and higher corporate compensation costs.

Research and development (“R&D”) expenses of \$403,000, or 2% of revenues (9% of Equipment segment revenues), for the first nine months of 2012 increased by \$21,000, or 5%, from \$382,000, or 2% of revenues (13% of Equipment segment revenues), for the first nine months of 2011. The increase is primarily attributable to an increase in regulatory costs.

Interest and Financing Costs

Interest and financing costs for the first nine months of 2012 and 2011 were \$3,000 and \$28,000, respectively. Interest and financing costs for the first nine months of 2012 consisted primarily of interest on the notes payable to a related party in one of the China subsidiaries. Interest and financing costs for the first nine months of 2011 consisted of interest on related party trade payables and a short-term note to finance the Company’s insurance premiums.

Interest and Other Income, Net

Interest and other income for the first nine months of 2012 and 2011, was \$123,000 and \$51,000, respectively. The increase of \$72,000 in the first nine months of 2012 is due primarily to value-added tax refunds recognized by our Chinese subsidiaries, as well as to higher interest earned on the Company’s cash balances.

Amortization of Deferred Gain on Sale-leaseback of Building

The amortization of the deferred gain on the sale-leaseback of our Westbury, NY facility for the first nine months of 2012 and 2011 was \$31,000 and \$40,000, respectively.

Income Tax Expense, Net

During the first nine months of 2012 we recorded a provision for income taxes of \$72,000 as compared to the first nine months of 2011 when we recorded a provision for income taxes of \$4,000. The increase arose primarily from foreign tax liabilities associated with the acquisition of FGE.





Vasomedical, Inc. and Subsidiaries

Liquidity and Capital Resources

Cash and Cash Flow

We have financed our operations primarily from working capital, and, in the first nine months of 2011, from the issuance of the Company's Series E Preferred Stock. At September 30, 2012, we had cash and cash equivalents of \$9,691,000, short-term investments of \$110,000 and working capital of \$7,731,000 compared to cash and cash equivalents of \$2,294,000, short-term investments of \$110,000 and working capital of \$11,354,000 at December 31, 2011.

Cash provided by operating activities was \$7,578,000 during the first nine months of 2012, which consisted of a net loss after adjustments to reconcile net loss to net cash of \$2,573,000, offset by cash provided by operating assets and liabilities of \$10,151,000. The changes in the account balances primarily reflect a decrease in accounts and other receivables of \$12,212,000, offset by a decrease in accrued commissions of \$1,945,000 and an increase in deferred commission expense of \$525,000. As noted above, under the GEHC Agreement the Company earns progressively higher commission rates as calendar year targets are met, which also has a significant impact on our cash flows. As we achieve these targets the higher commission rates are retroactive to the beginning of the calendar year, and therefore, the significantly higher commission billings and recognized revenue generated in the fourth quarter of 2011 resulted in significant cash inflows in the first quarter of 2012.

Cash used in investing activities during the nine-month period ended September 30, 2012 was \$344,000 for the purchase of property and equipment.

Financing activities during the nine-month period ended September 30, 2012 provided cash of \$153,000, consisting of \$343,000 provided from the exercise of warrants, offset by \$190,000 for the repayment of notes payable to a related party.

Liquidity

The Company will seek to improve profitability through our recent accretive acquisition of the two Chinese medical device companies and by expanding our U.S. market product portfolio. In addition, the Company plans to actively pursue other accretive acquisitions.

While we expect to generate positive operating cash flows for 2012, the progressive nature of the commission rates under the GEHC Agreement can cause related cash inflows to vary widely during the year.

Vasomedical, Inc. and Subsidiaries

ITEM 4 - CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures reporting as promulgated under the Exchange Act is defined as controls and procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms. Disclosure controls and procedures include without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Our CEO and our CFO have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2012 and have concluded that the Company’s disclosure controls and procedures were not effective as of September 30, 2012 due to insufficient controls and management review over the recording of certain transactions, and to lack of accounting personnel with appropriate level of knowledge and experience in accounting principles generally accepted in the United States of America and related accounting systems and the closing process at our China subsidiaries. The Company has engaged additional accounting personnel, including an accounting controller, and is in the process of strengthening its internal controls with regard to its closing process, related disclosures, and the approval of certain transactions.

Changes in Internal Control Over Financial Reporting

There was no change in the Company’s internal control over financial reporting during the Company’s last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

Vasomedical, Inc. and Subsidiaries

PART II - OTHER INFORMATION

ITEM 6 – EXHIBITS:

Exhibits

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

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

Vasomedical, Inc. and Subsidiaries

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 and Chief Executive Officer  
(Principal Executive Officer)

/s/ Michael J. Beecher  
Michael J. Beecher

Chief Financial Officer and Principal Accounting Officer

Date: November 19, 2012

Page 27

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