ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/
Form 10QSB
November 14, 2007
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-QSB

[x] Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended **September 30, 2007** or

[ ] Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from ______ to ______

1-9731
(*Commission file No.)*

ARRHYTHMIA RESEARCH TECHNOLOGY, INC.
(Exact name of small business issuer as specified in its charter)

DELAWARE	**72-0925679**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. employer identification no.)*

25 Sawyer Passway
Fitchburg, Massachusetts 01420
(Address of principal executive offices)

(978) 345-5000
(Issuer's telephone number, including area code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 shell company (as defined in Rule 12b-2 of the Exchange Act). Yes _ No X

As of November 1, 2007 there were 2,711,680 shares of the Company's common stock outstanding.

Transitional Small Business Disclosure Format Yes_ No _X

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PART I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY

Consolidated Balance Sheets

(Unaudited)

ASSETS	September 30, 2007	December 31, 2006
Current assets:		
Cash and cash equivalents	$ 2,194,603	$ 2,065,645
Trade and other accounts receivable, net of allowance for doubtful accounts of $49,830 and $29,830	2,737,518	2,857,937
Inventories, net	3,558,815	2,868,292
Deferred income taxes, net	57,000	57,000
Deposits, prepaid expenses and other current assets	684,523	476,153
Total current assets	9,232,459	8,325,027
Property and equipment, net of accumulated depreciation of $7,565,084 and $6,849,805	7,078,504	6,045,736
Goodwill	1,564,966	1,564,966
Other intangible assets, net	244,735	310,802
Deferred income taxes, net	70,000	70,000
Other assets	32,466	87,349
Total assets	$ 18,223,130	$ 16,403,880
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,729,799	$ 1,347,464
Accrued expenses	304,312	414,739
Current portion of acquisition note payable	61,633	61,633
Short term loan payable	382,959	-
	2,478,703	1,823,836

Total current liabilities		
Long term liabilities:		
Long term payables	10,210	25,836
Acquisition note payable, net of current portion	88,336	134,083
Total long term liabilities	98,546	159,919
Total liabilities	2,577,249	1,983,755
Shareholders' equity:		
Preferred stock, $1 par value; 2,000,000 shares authorized, none issued	-	-
Common stock, $0.01 par value; 10,000,000 shares authorized, 3,926,491 shares issued	39,265	39,265
Additional paid-in-capital	10,130,023	10,021,417
Common stock held in treasury, 1,214,811, and 1,220,811 shares at cost	(3,326,579)	(3,343,007)
Retained earnings	8,803,172	7,702,450
Total shareholders' equity	15,645,881	14,420,125
Total liabilities and shareholders' equity	$ 18,223,130	$ 16,403,880

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

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ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY

Consolidated Statements of Income

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
Revenue	$ 4,457,688	$ 4,412,628	$ 14,867,182	$ 13,338,035
Cost of sales	3,203,293	3,143,268	11,280,833	9,156,087
Gross profit	1,254,395	1,269,360	3,586,349	4,181,948
Selling and marketing	209,459	130,706	570,923	424,525
General and administrative	574,865	444,606	1,630,776	1,288,329
Research and development	14,594	12,207	44,971	50,144
Total expense	798,918	587,519	2,246,670	1,762,998
Income from operations	455,477	681,841	1,339,679	2,418,950
Other income (expense), net	(1,935)	12,134	(11,957)	14,500
Income before income taxes	453,542	693,975	1,327,722	2,433,450
Income tax provision	33,000	184,000	227,000	825,000
Net income	$ 420,542	$ 509,975	$ 1,100,722	$ 1,608,450
Net income per share – basic	$ 0.16	$ 0.19	$ 0.41	$ 0.60
Net income per share – diluted	$ 0.15	$ 0.19	$ 0.40	$ 0.59
Cash dividends declared per share	$ 0.00	$ 0.00	$ 0.00	$ 0.06
Weighted average common shares Outstanding – basic	2,711,680	2,668,194	2,709,973	2,666,934
Weighted average common shares Outstanding – diluted	2,765,103	2,714,822	2,785,411	2,703,588

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

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ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows

(Unaudited)

	Nine Months Ended September 30,	
	2007	**2006**
Cash flows from operating activities:		
Net income	$ 1,100,722	$ 1,608,450
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	837,163	627,787
Deferred income taxes	-	55,500
Share based compensation	32,325	6,807
Changes in operating assets and liabilities:		
Trade and other accounts receivable	120,419	(1,122,091)
Inventories	(690,523)	(958,368)
Deposits, prepaid expenses and other assets	(157,182)	(97,504)
Accounts payable and accrued expenses	256,282	1,562,142
Net cash provided by operating activities	1,499,206	1,682,723
Cash flows from investing activities:		
Capital expenditures, net of disposals	(1,417,210)	(906,964)
Net cash used in investing activities	(1,417,210)	(906,964)
Cash flows from financing activities:		
Payments on acquisition note payable	(45,747)	-
Cash dividend paid	-	(160,111)
Tax benefit from exercise of stock options	33,549	1,119
Proceeds from the exercise of stock options	59,160	19,720
Net cash provided by (used in) financing activities	46,962	(139,272)
Net increase in cash and cash equivalents	128,958	636,487
Cash and cash equivalents at beginning of period	2,065,645	1,931,823
Cash and cash equivalents at end of period	$ 2,194,603	$ 2,568,310

Supplemental Information:
At September 30, 2007 the Company has $1,118 of dividends payable.
A bank note for $382,959 provided a deposit for capital equipment in the current period.

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

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Notes to the Consolidated Financial Statements

1. Basis of Presentation:

The unaudited interim consolidated financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in complete financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The accompanying unaudited interim consolidated financial statements and related notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Arrhythmia Research Technology, Inc. and subsidiary (the "Company") Annual Report on Form 10-KSB for the year ended December 31, 2006.

The information presented reflects, in the opinion of the management of the Company, all adjustments necessary for a fair presentation of the financial results for the interim period presented.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Operating results for interim periods are not necessarily indicative of results that may be expected for the entire fiscal year.

2. Inventories:

Inventories consist of the following as of:	September 30, 2007	December 31, 2006
Raw materials	$ 1,404,756	$ 1,171,803
Work-in-process	517,096	525,515
Finished goods	1,636,963	1,170,974
Total	$ 3,558,815	$ 2,868,292

3. Share-Based Compensation:

The Company accounts for share based compensation under Statement of Financial Accounting Standards (SFAS) 123(R), *Share-Based Payment*, which accounts for equity instruments exchanged for employee services. Under the provisions of SFAS 123(R), share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity grant).

The Company estimates the fair value of stock options using the Black-Scholes valuation model. Key input assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, the expected volatility of the Company's stock over the option's expected term, the risk-free interest rate over the option's expected term, and the Company's expected annual dividend yield. The Company believes that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of the Company's stock options. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

The following assumptions were used to estimate the fair market value of options granted using the Black Scholes valuation method:

	Nine Months Ended September 30,	
	2007	2006
Dividend Yield	0.44%	1.2%
Expected Volatility	43%	42%
Risk Free Interest Rate	5.5%	4.9%
Expected Option Terms (in years)	6	6

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The Company recognized share-based compensation expense of $32,325 and $6,807 in general and administrative expense for the nine months ended September 30, 2007 and 2006, respectively. Two grants of 10,000 options each were made during the nine months ended September 30, 2007 compared with one grant of 10,000 for the same period in 2006. The fair value at grant was $176,500 and $53,800 during the nine months ended September 30, 2007 and the same period in 2006, respectively.

Share-based Incentive Plan

At September 30, 2007, the Company has one stock option plan that includes both incentive stock options and non-statutory stock options to be granted to certain eligible employees, non-employee directors, or consultants of the Company. At the annual shareholder meeting on May 11, 2007, the shareholders approved an amendment to the plan adding an additional 200,000 shares for future grant. The maximum number of shares reserved for issuance is 400,000 shares. The options granted have six-year contractual terms and either vest immediately or vest annually over a five-year term.

At September 30, 2007, there were 220,000 shares available for future grants under the above stock option plan. The weighted average exercise price of options outstanding was $10.45 at September 30, 2007.

The following table presents the average price and contractual life information about options outstanding and exercisable at September 30, 2007:

Exercise Price	Number of Outstanding Shares	Weighted Average Remaining Contractual Life (years)	Options Currently Exercisable
$ 4.85	25,000	1.83	20,000
9.86	72,000	4.22	72,000
12.42	10,000	4.85	2,000
14.10	10,000	5.68	-
23.10	10,000	5.43	-

The aggregated intrinsic value of options outstanding and vested at September 30, 2007 was $206,730 and $177,480, respectively. The intrinsic value of options exercised during the period ended September 30, 2007 and 2006 was $158,000 and $2,500, respectively. The Company expects 30,000 of the 33,000 options to vest over their remaining life.

The following table summarizes the status of Company's non-vested options since December 31, 2006:

	Non-Vested Options	
	Number of Shares	Weighted Average Fair Value
Non-vested at December 31, 2006	20,000	$ 3.67
Granted	20,000	8.83
Vested	(7,000)	2.01
Forfeited	-	-

Non-vested at September 30, 2007	33,000	$ 7.15

At September 30, 2007, there was $197,607 of total unrecognized cost related to non-vested share-based compensation arrangements granted under the Plan. This cost is expected to be recognized over a weighted average period of 5.34 years.

4. Income Taxes

On January 1, 2007, the Company adopted FASB Interpretation No. 48 (“FIN 48”), *Accounting for Uncertainty in Income Taxes* which is an interpretation of SFAS No. 109, *Accounting for Income Taxes*. FIN 48 requires management to perform a two-step evaluation of all tax positions, ensuring that these tax return positions meet the “more-likely than not” recognition threshold and can be measured with sufficient precision to determine the benefit recognized in the financial statements. As a result of the implementation of FIN 48, the Company recognizes taxes at statutory rates minus tax credits and net operating loss carry forwards as disclosed on the Company’s Form 10-KSB for the year ended December 31, 2006.

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The Company has filed amended returns for 2003 and 2004 in order to take advantage of tax credits in those respective periods. The refunds due for those periods offset the Company's tax provision in the current period. An IRS audit was completed during the period and, the IRS issued a no change letter.

The Company files income tax returns in the U.S. Federal jurisdiction and various state jurisdictions. The periods from 2001 to 2006 remain open to examination by the IRS and state jurisdictions. The Company believes it is not subject to any significant tax risk. As of the date of adoption of FIN No. 48, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the nine months ended September 30, 2007.

5. Recent Accounting Pronouncements:

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 prescribes a single definition of fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company does not believe the adoption of SFAS No. 157 will have a material impact on its financial condition or results of operations. SFAS No. 157 is effective for the Company's interim reporting period beginning January 1, 2008.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Company does not believe the adoption of SFAS No. 159 will have a material impact on its financial condition or results of operations. SFAS No. 159 is effective for the Company's interim reporting period beginning January 1, 2008.

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

Forward-Looking Statements

Any forward looking statements made herein are based on current expectations of the Company, involve a number of risks and uncertainties and should not be considered as guarantees of future performance. The factors that could cause actual results to differ materially include: interruptions or cancellation of existing contracts, inability to integrate acquisitions, impact of competitive products and pricing, product demand and market acceptance risks, the presence of competitors with greater financial resources than the Company, product development and commercialization risks, and changing economic conditions in developing countries. More information about factors that potentially could affect the Company's financial results is included in the Company's filings with the Securities and Exchange Commission, including its Annual Report on Form 10-KSB for the year ended December 31, 2006.

Overview

Arrhythmia Research Technology, Inc. ("ART") is engaged in the licensing of medical software, which acquires data and analyzes electrical impulses of the heart to aid in the detection of patients who may be at risk for potentially lethal arrhythmias. Micron Products, Inc. ("Micron"), a wholly owned subsidiary, is the primary source of consolidated revenues. Micron manufactures disposable electrode sensors used as a component part in the manufacture of integrated disposable electro-physiological sensors. These disposable medical devices are used world wide in the monitoring of electric signals in various medical applications. The Company has previously acquired and integrated into Micron's facility a custom plastic injection molding company now called the New England Molders division

(“NEM”). In January 2006, the Company formed a new division called Micron Integrated Technologies (“MIT”) which provides end-to-end product life cycle management through a comprehensive portfolio of value-added services such as design, engineering, prototyping, manufacturing, machining, assembly and packaging. In December 2006, the Company acquired the operating assets of Leominster Tool Co. Inc. Micron’s Leominster Tool division provides high end mold design, manufacturing and precision machining to various industries.

Results of Operations

Revenue for the nine months ended September 30, 2007 was $14,867,182 versus $13,338,035 for the nine months ended September 30, 2006, an increase of 11%. Micron’s medical sensors and snaps with silver surcharge decreased by $1,642,000 while high volume precision molded products and other miscellaneous sales increased by $324,000. More than half of the decrease in sensors and snaps sales was due to a drop in European sensor sales. The remaining decrease was due to the shift of a customer’s orders normally filled by Micron to a competitor due to pricing differences. Revenue from NEM’s custom molded products decreased $233,000 as a result of one customer shifting component production to an offshore facility. MIT’s products increased in revenue by $2,523,000 offsetting the decrease in sensors and custom molding for the nine months of 2007. The new Leominster Tool division contributed $557,000 to the increase in revenues. Additionally, the division produced orthopedic implants and tools for customers of the other divisions. There were no sales of the Company’s SAECG products in the first nine months of 2007 or 2006.

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Revenue from domestic and foreign sales for the first nine months is as follows:

	Nine Months Ending September 30,			
	2007	%	2006	%
United States	$ 8,358,543	56	$ 5,698,864	43
Canada	4,041,121	27	4,550,951	34
Europe	1,884,500	13	2,617,891	19
Pacific Rim	278,189	2	245,364	2
Other	304,829	2	224,965	2
Total	$ 14,867,182	100	$ 13,338,035	100

The significant increase in domestic sales was a result of the MIT division's sales. Canadian and European sales decreases are the result of a reduction in volume of two products in Micron's electrophysiological sensor and snap product lines and corresponding reduction in silver surcharge collected.

Cost of sales was 76% of revenue for the nine months ended September 30, 2007 compared to 69% of revenue for the same period in 2006. A change in product mix and decrease in volume in the sensor business had an impact in the period. Volume shifts in the NEM and MIT divisions were comprised of products with a lower gross profit percentage compared to the historical gross profit percentage realized on Micron sensors. Although management has been successful in stabilizing a portion of the electricity costs by negotiating a long-term purchase agreement which is due to end in December, other manufacturing costs continue to rise. The inability to increase our sensor prices in the competitive global marketplace hinders passing material cost increases to our customers excluding the escalating cost of silver. The Leominster Tool division has not yet been fully integrated to take advantage of some of the expected synergistic benefits. Management continues to investigate strategies to both stabilize and improve the overall gross margin without sacrificing product quality and to expand higher margin product lines.

Selling and marketing expense was $570,923 for the nine months ended September 30, 2007 as compared to $424,525 for the same period in 2006. The selling and marketing expense was 4% of sales in the nine months ended September 30, 2007 and 3% for the same period in 2006. Selling expenses increased as a percentage of sales due to expanded business development efforts. These efforts included increased personnel, travel expenses, and trade show attendance. This cost as a percentage of sales is expected to stabilize and begin to decrease as revenues from such increased development efforts begin to be realized in 2008.

General and administrative expense was $1,630,776 for the nine months ended September 30, 2007 as compared to $1,288,329 for the same period in 2006. The general and administrative expense was 11% of sales in the nine months ended September 30, 2007 and 10% for the same period in 2006. The increase was related to salary increases, additional administrative personnel, and technology upgrades in preparation for Section 404 of the Sarbanes-Oxley Act of 2002 compliance. The cost associated with the internal control documentation began during the second quarter of 2007, as the Company implements a new enterprise resource planning solution to improve data collection and reporting in all aspects of the business. The fourth quarter of 2007 will include increased costs associated with Section 404 compliance efforts.

Research and development expense was $44,971 for the nine months ended September 30, 2007 as compared to $50,144 for the same period in 2006. The expense was related to ART's product, Predictor® 7. Although base development work on Predictor 7 has been completed, product testing costs were expended to support a research project utilizing ART's proprietary Signal Averaged ECG products and patented algorithms.

Other expense, net was $11,957 versus an income of $14,500 for the nine months ended September 30, 2007 and 2006, respectively. Interest income in the period ended September 30, 2007 was offset by interest expense of $19,832 associated with the acquisition note and a loss on retired assets. The income in the same period in 2006 was the result of interest income on cash balances.

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Income taxes as a percent of income before income taxes were 17% and 34% for the nine months ended September 30, 2007 and 2006, respectively, as a result of the realization of tax credits earned and associated tax refunds related to prior periods, which amounted to $92,000. A portion of the $92,000 credit from a prior period amended return was received in October 2007. Management expects to receive the remaining balance in the near future. Management will continue to seek to implement any tax planning opportunities that could effectively reduce the Company's income tax provision in the future.

Liquidity and Capital Resources

Working capital was $6,753,756 at September 30, 2007 compared to $6,501,191 at December 31, 2006, an increase of $252,565. The increase reflects the increase in revenues and the net of the increased inventory and accounts payable. Increases in working capital were partially offset by the net of capital investment and a new equipment loan. Working capital could decrease with any significant investment resulting from future acquisition of assets or businesses, significant expansion of production capacity, participation in a medical study, or further software development.

Net capital expenditures were $1,800,169 for the first nine months of 2007 as compared to $906,964 for the same period in 2006. The largest portion of the capital expenditures in the first nine months of 2007 and 2006 were for the acquisition of additional production machinery and equipment, including upgrades in and replacement of existing machinery and tooling. The Company has committed to an additional $500,000 in manufacturing equipment associated with the creation of a medical machining capability within its existing location to meet demands for new products. Included in the capital expenditures for 2007 are the acquisition of an adjacent property to the Company's Fitchburg complex, and an enterprise resource planning software solution purchased and implemented to improve internal controls and reporting.

The Company has an unsecured $1,000,000 credit line with a large multinational bank. No funds have been drawn down on the line as of September 30, 2007 or December 31, 2006. In September 2007, the Company entered into a one year loan for $813,000 at the fixed rate of 6.75% per annum for metal machining equipment from a local savings bank. This loan was drawn down by $383,000 as a deposit on equipment with an expected delivery in November 2007.

The Company expects to meet cash demands for its operations at current levels with current operating cash flows for the foreseeable future.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with generally accepted accounting principles requires management to make judgments, assumptions and estimates that affect the amounts reported. Certain of these significant accounting policies are considered to be critical accounting policies, as defined below.

A critical accounting policy is defined as one that is both material to the presentation of the Company's financial statements and requires management to make difficult, subjective, and complex judgments that could have a material effect on the Company's financial condition and results of operations. Specifically, critical accounting estimates have the following attributes: 1) the Company is required to make assumptions about matters that are highly uncertain at the time of the estimate; and 2) different estimates the Company could reasonably have used, or changes in the estimate that are reasonably likely to occur, would have a material effect on the Company's financial condition or results of operations.

Estimates and assumptions about future events and their effects cannot be determined with certainty. The Company bases its estimates on historical experience and on various other assumptions believed to be applicable and reasonable in the circumstances. These estimates may change as new events occur, as additional information is obtained and as the Company's operating environment changes. These changes have historically been minor and have been included in the consolidated financial statements as soon as they became known. In addition, management is periodically faced with uncertainties, the outcomes of which are not within its control and will not be known for prolonged periods of time. These uncertainties are discussed in the section above entitled "Forward-looking Statements." Based on a critical assessment of its accounting policies and the underlying judgments and uncertainties affecting the application of those policies, management believes that the Company's consolidated financial statements are fairly stated in accordance with generally accepted accounting principles, and present a meaningful presentation of the Company's financial condition and results of operations.

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Management believes that the following are critical accounting policies:

Revenue Recognition and Accounts Receivable

Revenues from the sale of products are recorded when the product is shipped, title and risk of loss have transferred to the purchaser, payment terms are fixed or determinable and payment is reasonably assured.

The financing of customer purchased tooling utilizes the direct financing method of revenue recognition. This requires the gain on the sale of the tooling to be recorded at the time the tool is put into service while the expected payments are reflected as a lease receivable.

Based on management's on-going analysis of accounts receivable balances, and after the initial recognition of the revenue, if an event occurs which may adversely affect the ultimate collectibility of the related receivable, management will record an allowance for the bad debt. Bad debts have not had a significant impact on the Company's financial condition, results of operations or cash flows.

Stock-Based Compensation

The Company accounts for share based compensation under SFAS No. 123R, *"Share Based Payment"* ("FAS 123R"). FAS 123R requires that companies recognize and measure compensation expense for all share-based payments at the grant date based on the fair market value of the award. This share-based compensation expense must be included in the Company's statement of income over the requisite service period. The provisions of FAS 123R apply to new stock options and stock options outstanding but not yet vested on the effective date.

The Company uses the Black-Scholes option pricing model which requires extensive use of financial estimates and accounting judgment, including the expected volatility of the Company's common stock over the estimated term, estimates on the expected time period that employees will retain their vested options prior to exercising them, and the number of shares that are expected to be forfeited before the options are vested. The use of alternative assumptions could produce significantly different estimates of the fair value of the stock-based compensation and as a result, provide significantly different amounts recognized in the Company's statement of income.

Inventory and Inventory Reserves

The Company values its inventory at the lower of cost or market. The Company reviews its inventory for quantities in excess of production requirements, obsolescence and for compliance with internal quality specifications. Any adjustments to inventory would be equal to the difference between the cost of inventory and the estimated net market value based upon assumptions about future demand, market conditions and expected cost to distribute those products to market. If actual market conditions are less favorable than those projected by management, additional inventory reserves may be required.

The Company maintains a reserve for excess, slow moving, and obsolete inventory as well as inventory with a carrying value in excess of its net realizable value. A review of inventory on hand is made at least annually and a provision for excess, slow moving, and obsolete inventory is recorded, if necessary. The review is based on several factors including a current assessment of future product demand, historical experience, and product expiration.

Deferred Tax Assets

The Company assesses its deferred tax assets based upon a more likely than not to be realized criteria. The Company considers future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the

valuation allowance.

The Company files income tax returns in the U.S. Federal jurisdiction and various state jurisdictions. The periods from 2000 to 2006 remain open to examination by the IRS and state jurisdictions. The Company believes it is not subject to any significant tax risk, nor does it have any accrued interest or penalties associated with any unrecognized tax benefits.

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Asset Impairment – Goodwill

The Company reviews the valuation of goodwill and intangible assets to assess potential impairments on an annual basis, typically during the first quarter. The management evaluates the carrying value of goodwill and other intangible assets in accordance with the guidelines set forth in SFAS 142. The value assigned to intangible assets is determined by a valuation based on estimates and judgment regarding expectations for the success and life cycle of products and businesses acquired. To test for impairment, present values of an estimate of future discounted cash flows related to the intangible assets are calculated compared to the value of the intangible asset. Impairment may have a material adverse effect on the Company's financial condition or results of operations. There was no impairment as of September 30, 2007.

Asset Impairment – Long Lived Assets

The Company assesses the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be fully recoverable. When it is determined that the carrying value of such assets may not be recoverable, the Company generally measures any impairment based on projected undiscounted future cash flows attributed to the asset and its carrying value. If the carrying value exceeds the future discounted cash flows, asset impairment would be recorded.

Item 3. Controls and Procedures

As of the end of the period covered by this Quarterly Report, the Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer ("the Certifying Officers"), conducted evaluations of the Company's disclosure controls and procedures. As defined under Sections 13a – 15(e) and 15d – 15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the term "disclosure controls and procedures" means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, included the Certifying Officers, to allow timely decisions regarding required disclosures. Based on this evaluation, the Certifying Officers have concluded that the Company's disclosure controls and procedures were effective to ensure that material information is recorded, processed, summarized and reported by management of the Company on a timely basis in order to comply with the Company's disclosure obligations under the Exchange Act and the rules and regulations promulgated thereunder.

Further, there were no changes in the Company's internal control over financial reporting during the Company's third fiscal quarter that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 5. Other Information.

On November 12, 2007, the Company announced the results of operations for the quarter ended September 30, 2007. A copy of the press release is appended hereto as exhibit 99.01.

Item 6. Exhibits

(a) Exhibits

3.0	Articles of Incorporation[(a)]
3.1	By-laws[(b)]
10.43*	Employment agreement between James E. Rouse and the Company dated December 26th, 2006.[(d)]
10.44*	agreement between David A. Garrison and the Company dated January 1st, 2007.(d)
10.45*	Employment agreement between Michael F. Nolan and the Company dated June 4, 2007. (e)
31.1	Certification of the CEO pursuant to Rule 13a-14(a) or Rule 15(d)-14(a) on page X-1.
31.2	Certification of the CFO pursuant to Rule 13a-14(a) or Rule 15(d)-14(a) on page X-2.
32.1	Certification pursuant to 18 U.S.C. §1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 on page X-3.
32.2	Certification pursuant to 18 U.S.C. §1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 on page X-4.
99.01	Press Release dated November 12, 2007 announcing its financial results for the quarter ended September 30, 2007 on page X-5.

* Indicates a management contract or compensatory plan required to be filed as an exhibit.

(a) Incorporated by reference from the Company's Registration Statement on Form S-18 as filed with the Commission in April 1988, Registration Statement No. 33-20945-FW.

(b) Incorporated by reference from the Company's Form 10-Q for period ended September 30, 2002 as filed with the Commission in November 2002.

(c) Incorporated by reference from the Company's Form 8-K as filed with the Commission on May 21, 2004.

(d) Incorporated by reference from the Company's Form 10-KSB for period ended December 31, 2006 as filed with the Commission in March of 2007.

(e) Incorporated by reference from the Company's Form 10-QSB for period ended June 30, 2007 as filed with the Commission in August of 2007.

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ARRHYTHMIA RESEARCH TECHNOLOGY, INC.

By: /s/ James E. Rouse
James E. Rouse
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ David A. Garrison
David A. Garrison
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

November 14, 2007

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