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EYE DYNAMICS INC
Form 10QSB
August 16, 2004

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 June 30, 2004.

Commission File No. 0-27857

EYE DYNAMICS, INC.

(Name of small business issuer as specified in its charter)

Nevada

(State or other jurisdiction
of incorporation)

88-0249812

(I.R.S. Employer Identification No.)

2301 W. 205th Street, #102, Torrance, CA 90501

(Address of principal executive offices)

310-328-0477

(Issuer's telephone number)

The number of shares outstanding of the issuer's common stock as of June 30, 2004 was 17,883,081.

Transitional Small Business Disclosure Format (check one) () Yes; (X) No.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

CONSOLIDATED BALANCE SHEET

ASSETS	
Current Assets	
Cash	\$ 737,943
Accounts receivable	204,182
Employee advances and receivable, net of allowance for loan losses of \$58,218	200
Inventory	321,068
Prepaid expenses and taxes	35,163

Total Current Assets	1,298,556

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Property and equipment, net of accumulated depreciation of \$14,455	989
Other Assets	219,098

TOTAL ASSETS	\$ 1,518,643
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current Liabilities	
Accounts payable	\$ 29,685
Accrued expenses	20,208
Notes payable, current portion	55,443

Total Current Liabilities	105,336
Long-term debt and accrued interest	325,138

Total Liabilities	430,474

Stockholders' Equity	
Common Stock, \$0.001 par value; 50,000,000 shares authorized; 17,883,081 shares issued and outstanding	17,883
Paid-in Capital	3,497,069
Accumulated Deficit	(2,426,783)

	1,088,169

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 1,518,643
	=====

CONSOLIDATED STATEMENTS OF OPERATIONS

	For Three Months ended June 30,		For Six Months ended June	
	2004	2003	2004	2003
	-----		-----	
Sales - Products	\$ 456,581	\$ 688,018	\$ 1,065,457	\$ 1,065,457
Cost of Products	213,451	386,140	506,433	506,433
	-----		-----	
Gross profit	243,130	301,878	559,024	559,024
Selling, general and administrative expenses	174,473	161,059	348,153	348,153
	-----		-----	
Operating income	68,657	140,819	210,871	210,871
	-----		-----	
Other income (expenses)				
Interest and other income	--	29	60	60

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Interest and other expense	(921)	(14,360)	(2,030)
	(921)	(14,331)	(1,970)
Net income before taxes	67,736	126,488	208,901
Provision for income taxes	--	25,496	800
Net income	\$ 67,736	\$ 100,992	\$ 208,101
Net income per share-basic	\$ 0.00	\$ 0.01	\$ 0.01
Net income per share-diluted	\$ 0.00	\$ 0.00	\$ 0.00
Shares used in per share calculation-basic	17,883,081	17,850,313	17,883,081
Shares used in per share calculation-diluted	21,763,168	21,647,240	21,763,168

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR SIX MONTHS ENDED JUNE 30,	2004	2003
CASH FLOW FROM OPERATING ACTIVITIES:		
Net Income	\$ 208,101	\$ 257,695
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	114	204
(Increase) Decrease in:		
Accounts Receivable	(72,762)	72,800
Inventory	(1,115)	(62,129)
Prepaid and Others	(29)	(27,810)
(Decrease) in:		
Accounts Payable and Accrued Expenses	(56,908)	(48,623)
Other Liabilities	--	(13,271)
Net cash provided by operating activities	77,401	178,866
CASH FLOW FROM INVESTING ACTIVITIES:		
Purchase of Property and Equipment	--	(1,113)
Employee loan and advances	(200)	(257)
Net cash (used in) investing activities	(200)	(1,370)
CASH FLOW FROM FINANCING ACTIVITIES:		
Repayments on Notes Payable	(39,602)	(50,856)
Net cash (used in) financing activities	(39,602)	(50,856)

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NET INCREASE IN CASH	37,599	126,640
CASH BALANCE AT BEGINNING OF PERIOD	700,344	177,668
CASH BALANCE AT END OF PERIOD	\$ 737,943	\$ 304,308

Supplemental Disclosures of Cash Flow Information:

Interest Paid	\$ --	\$ 78,889
Taxes Paid	\$ 58,555	\$ --

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF BUSINESS: Eye Dynamics, Inc. (the "Company") designs, develops, produces and markets diagnostic equipment that measures, tracks and records human eye movements, utilizing the Company's proprietary technology and computer software. The products perform separate, but related, functions and target two separate markets. First, the Company markets a neurological diagnostic product that tracks and measures eye movements during a series of standardized tests, as an aid in diagnosing problems of the vestibular (balance) system and other balance disorders. Second, the Company's impairment detection devices target the corporate and criminal justice markets and are designed to test individuals for impaired performance resulting from the influences of alcohol, drugs, illness, stress and other factors that affect eye and pupil performance. The Company is a Nevada corporation formed in 1989.

A summary of significant accounting policies follows:

PRESENTATION OF INTERIM INFORMATION: The financial information at June 30, 2004 and for the three and six months ended June 30, 2004 and 2003 is unaudited but includes all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for a fair presentation of the financial information set forth herein, in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information, and with the instructions to Form 10-QSB. Accordingly, such information does not include all of the information and footnotes required by U.S. GAAP for annual financial statements. For further information refer to the Consolidated Financial Statements and footnotes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2003.

The results for the three and six months ended June 30, 2004 may not be indicative of results for the year ending December 31, 2004 or any future periods.

RECLASSIFICATION: Certain prior period balances have been reclassified to conform to the current period presentation.

NEW ACCOUNTING STANDARDS: In December 2003, the SEC issued Staff Accounting Bulletin (SAB) No. 104, "Revenue Recognition," which codifies, revises and rescinds certain sections of SAB No. 101, "Revenue Recognition," in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on the Company's results of operations, financial positions or cash flows.

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NOTE 2 - WIND DOWN OF SUBSIDIARY

On September 15, 2003, the Board of Directors approved to wind down the Company's sole subsidiary, Oculokinetics, Inc., which was inactive and has no asset or liability as of that date.

NOTE 3 - BALANCE SHEET DETAILS

The following tables provide details of selected balance sheet items:

At June 30,	2004	2003

Prepaid expenses and taxes		
Prepaid insurance	\$ 17,387	\$ --
Prepaid income taxes	15,760	--
Other prepaid expenses	2,016	8,674

Total	\$ 35,163	\$ 8,674
=====		
Property and equipment, net		
Furniture and Fixtures	\$ 1,113	\$ 2,545
Equipment	13,331	13,331

Less: accumulated depreciation	14,444 (13,455)	15,876 (14,467)

Total	\$ 989	\$ 1,409
=====		
Other Assets		
Commission payable	\$ 10,770	\$ 21,166
Warranty reserve	6,779	--
Accrued interest	4,239	52,672
Other	(1,580)	(425)

Total	\$ 20,208	\$ 73,413
=====		

NOTE 4 NET INCOME PER SHARE

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

	Three Months ended June 30, 2004	2003	Six Months ended 2004
	-----	-----	-----
Basic earnings per share:			
Net income	\$ 67,736	\$ 100,992	\$ 208,801
Weighted average number of common shares	17,833,081	17,850,313	17,883,081
Basic earnings per common share	\$ 0.00	\$ 0.01	\$ 0.01
=====			
Diluted earnings per share:			
Net income	\$ 67,736	\$ 100,992	\$ 208,801
Addback: Debenture interest	700	763	1,400
	-----	-----	-----

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Adjusted net income	\$	68,436	\$	101,755	\$	210,201	\$
<hr style="border-top: 1px dashed black;"/>							
Weighted average number of common shares		17,883,081		17,850,313		17,883,081	
Incremental shares from assumed conversion:							
Convertible debt		3,591,799		3,591,799		3,591,799	
Stock warrants		288,288		205,128		288,288	
<hr style="border-top: 1px dashed black;"/>							
Adjusted weighted average number of common shares		21,763,168		21,647,240		21,763,168	
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Diluted earnings per common share	\$	0.00	\$	0.00	\$	0.01	\$
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Approximately, 200,000 shares issuable under outstanding stock warrants were excluded from the calculation of diluted earnings per share for 2003 because the exercise price of the stock warrants was greater than the average share price of the common stock and, therefore, the effect would have been antidilutive.

NOTE 5 - INCOME TAXES

The Company accounts for income taxes using a balance sheet approach whereby deferred tax assets and liabilities are determined based on the differences in financial reporting and income tax basis of assets and liabilities. The differences are measured using the income tax rate in effect during the year of measurement.

The Company experienced significant net losses in prior fiscal years resulting in a net operating loss carryforward ("NOLC") for federal income tax purposes of approximately \$1,531,790 at December 31, 2003. The Company's NOLC will expire through 2021. The Company also has state NOLC of \$901,140, which was suspended in years of 2002 and 2003. The state NOLC will expire through 2013.

NOTE 6 - MAJOR CUSTOMERS

During the three months ended June 30, 2004 and 2003, the private label distributor accounted for \$327,659 and \$322,451 or 71.8% and 46.9% of total revenues, respectively.

During the six months ended June 30, 2004, two customers accounted for \$791,261 or 74.3% of total revenues.

Special Instrument Dealer 21.2%
Private label distributor 53.1%

During the six months ended June 30, 2003, the private label distributor accounted for \$733,215 or 54.7% of total revenues.

NOTE 7 - SEGMENT INFORMATION

SFAS No. 131 Disclosures about Segments of an Enterprise and Related Information requires that a publicly traded company must disclose information about its operating segments when it presents a complete set of financial statements. Since the subsidiary did not have any operations in 2003, and the Company has only one segment; accordingly, detailed information of the reportable segment is not presented.

NOTE 8 - MANUFACTURING, SALES, LICENSING, AND SOFTWARE AGREEMENT

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On March 22, 2004, the Company entered into an exclusive manufacturing, sales, and licensing and software ownership agreement with its private label distributor (Distributor). Under the terms and conditions of the contract, the Distributor agrees to purchase all of its current and future Video ENG products exclusively from the Company. In addition, the Company grants the Distributor the exclusive marketing rights for all of its Video ENG products throughout the United States.

NOTE 9 GUARANTEES AND PRODUCT WARRANTIES

The Company from time to time enters into certain types of contracts that contingently require the Company to indemnify parties against third party claims. These contracts primarily relate to: (i) divestiture agreements, under which the Company may provide customary indemnifications to purchasers of the Company's businesses or assets; (ii) certain real estate leases, under which the Company may be required to indemnify property owners for environmental and other liabilities, and other claims arising from the Company's use of the applicable premises; and (iii) certain agreements with the Company's officers, directors and employees, under which the Company may be required to indemnify such persons for liabilities arising out of their employment relationship. The terms of such obligations vary. Generally, a maximum obligation is not explicitly stated. Because the obligated amounts of these types of agreements often are not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, the Company has not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations on its balance sheet as of June 30, 2004.

In general, the Company offers a one-year warranty for most of the products it sold. To date, the Company has not incurred any material costs associated with these warranties. The Company provides reserves for the estimated costs of product warranties based on its historical experience of known product failure rates, use of materials to repair or replace defective products and service delivery costs incurred in correcting product failures. In addition, from time to time, specific warranty accruals may be made if unforeseen technical problems arise with specific products. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

The following table presents the changes in the Company's warranty reserve during the first six months of 2004:

Balance as of December 31, 2003	\$ 8,044
Provision for warranty	2,609
Utilization of reserve	(3,894)

Balance as of June 30, 2004	\$ 6,779
	=====

ITEM 2. Management's Discussion and Analysis or Plan of Operation

PERIOD ENDED JUNE 30, 2004 COMPARED TO PERIOD ENDED JUNE 30, 2003.

Revenues from the sale of medical products during the second quarter of 2004 totaled \$456,581, representing a 34% decrease from revenues during the same quarter of 2003. Net income after taxes of \$467,736 during the current quarter decreased commensurately, but still represents 14% of revenues for the period. Revenues for the first half of 2004 were \$1,065,457, compared to \$1,340,626 for the same period of 2003. After tax income for the six month period was \$208,101, compared to \$257,695 in 2003. Earnings per share of \$0.01 for the first half is the same in 2004 as in 2003.

Lower sales can be attributed to Medicare's continued scrutiny of reimbursements for ENG tests. This has caused potential new customers to delay

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or, in some cases, abandon their plans to purchase equipment. Medicare generally requires that only ENT doctors, neurologists or audiologists perform ENG tests in order to be assured of reimbursement. This development has caused much concern within the industry, because many physicians have utilized trained medical technicians to administer the ENG test for years. This issue is being debated and is not yet settled.

The private label portion of our business accounted for 72% of revenues for the quarter, as opposed to 47% of revenues during the same quarter of 2003. For the six month period, the private label portion of the business represents 53% of total revenues, compared to 55% for the same period in 2003.

Gross profit for the quarter was 53%, slightly higher than the prior quarter. Year to date gross profit is 52%. The Company's goal is to maintain a gross profit of at least 50% for each period. The Company is working to contain expenses and to reduce product costs in order to achieve the gross profit percent goal. Principal operating expense increases have been in insurance, including product liability, workers compensation and general liability. The cost of product liability insurance was the greatest change, at four times the rate of 2003.

The Company incurred only the minimum California state income tax because the moratorium on the use of tax loss carryovers for the years 2002 and 2003 expired, and the use of net operating loss carryovers is put back into place. Federal tax loss carryovers were not affected and because of substantial NOL's, the Company is not required to accrue federal income taxes for 2004.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents as of June 30, 2004 of \$737,943 allow for payment of all outstanding invoices and our single note payment on a current basis. Accounts payable are current and the Company has not borrowed against credit lines.

Inventory of \$321,068 at June 30, 2004 includes \$25,000 of SafetyScope Impairment Detection Device items, which are not currently being actively marketed, but are used as production samples and demonstrators for capital-raising activities related to that business. The inventory balance of \$296,000 represents almost 3 months of consumption, and is balanced in content. However, management believes the amount is too high for the volume of sales and is in process of being reduced to an appropriate level. In the second quarter inventory was reduced by 10%, and the Company plans to reduce it even more. The higher inventory is the result of the slowdown in sales and sufficient time has not yet passed to reduce the inventory to an acceptable level.

Accounts receivable of \$204,000 represents less than 60 days accounts receivable aging, which is acceptable, and efforts to reduce it to a 30 day level have shown some progress. At March 31, 2004 the accounts receivable were \$366,000, so there has been a substantial reduction. The company's private label customer makes payments within the net 15 days term of sale. We are encouraging other customers to utilize leasing and credit cards with more frequency, providing for quicker collection of receivables.

The Company continues to seek financing for the business plan to commercialize the SafetyScope product, which is an Impairment Detection Device. The plan requires substantial financial resources to fully implement the commercialization of the product. Discussions and explorations of strategic

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alliances are ongoing with the goal of securing the financing; however the Company has no arrangements or agreements as to any such financing.

The Company continues to search out and evaluate other products and alliances to enhance its product lines and to augment revenues. The search for new products is an ongoing project.

Sales prospects for the rest of the year are encouraging, but not as robust as 2003. Some buyers are now moving forward with purchases that had been delayed earlier in the year.

Item 3. Controls and Procedures.

At the end of the period covered by this Form 10-QSB, the Company's management, including the Chief Executive and Financial Officer, conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, the Chief Executive and Financial Officer determined that such controls and procedures are effective to ensure that information relating to the Company required to be disclosed in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. There have been no changes in the Company's internal controls over financial reporting that were identified during the evaluation that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

The Company is not a party to any pending legal proceedings.

Item 2. Changes In Securities And Use Of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission Of Matters To A Vote Of Security Holders

There were no matters submitted to the vote of security holders during this quarterly reporting period.

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- | | |
|----|---|
| 31 | Certificate of Chief Executive and Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | Certificate of Chief Executive and Financial Officer pursuant |

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to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

None.

SIGNATURES

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.

Date: August 16, 2004

By: /s/ Charles E. Phillips

Charles E. Phillips, President and Chief Financial Officer