Vasomedical Inc.

EECP®

2002 Annual Report

Improving lives for heart patients and their families

Vasomedical

The Company is dedicated to providing superior medical products and services that address unmet clinical needs in the management of chronic cardiovascular diseases and to helping thousands of patients and their families each year return to active and productive lives.

About the Company

Vasomedical is the leading developer and manufacturer of EECP® enhanced external counterpulsation systems for the treatment of symptomatic coronary artery disease and congestive heart failure (CHF). EECP is a clinically proven, noninvasive therapy that utilizes pneumatic cuffs to compress the lower extremities in time with a patient's cardiac cycle. The therapy serves to increase circulation in areas of the heart with less than adequate blood supply and may restore systemic vascular function. EECP is currently indicated for use in patients with stable or unstable angina, acute myocardial infarction, cardiogenic shock and CHF.

Table of Contents

Highlights of the Year

- Vasomedical reported its third consecutive profitable year and achieved record revenues of $34.8 million, up 27%.

- Vasomedical's EECP® enhanced external counterpulsation systems were granted 510(k) market clearance by the Food and Drug Administration for the treatment of congestive heart failure (CHF).

- Results of a feasibility study on the use of EECP in CHF were published in the July/August 2002 issue of the journal **Congestive Heart Failure.**

- Patient enrollment for the PEECH™ (Prospective Evaluation of EECP in Congestive Heart Failure) trial exceeded the halfway mark.

- A Continuing Medical Education symposium sponsored by the University of Minnesota and supported by Vasomedical was held March 16, 2002 prior to the Annual Scientific Sessions of the American College of Cardiology in Atlanta. The symposium, **EECP: Current Experience and Future Directions,** was the largest such event ever supported by the Company.

- A study by Masuda D, *et al* suggesting that EECP stimulates the development of collateral blood vessels, circumventing blocked arteries and restoring blood flow to oxygen-deprived areas of the heart, was listed by the American Heart Association as a featured presentation at its 2001 Annual Scientific Sessions.

- Results of a one-year follow-on study to the MUST-EECP trial published in the **Journal of Investigative Medicine** showed dramatic improvements in health-related quality of life for patients with angina at one year following the completion of a course of EECP therapy.

- Medicare reimbursement rates for EECP therapy were increased by the Centers for Medicare and Medicaid Services an average of 7% beginning January 2002.

- Vasomedical was ranked third in Deloitte & Touche's **Fast 50** list of Long Island's fastest growing companies.

Dear Fellow Shareholders:

The past year was marked by continued growth and achievement for Vasomedical in a number of key areas. The Company's EECP® Therapy System Model TS3 established itself as the new standard in external counterpulsation therapy. In June 2002, the Company's EECP systems were granted market clearance by the FDA for use in the treatment of congestive heart failure (CHF), a vast and important new market opportunity. The Company continued to strengthen its intellectual property rights by filing a number of new patent applications, many of which have important strategic implications for the new indication. Consistent with Vasomedical's commitment to patient well-being and better understanding the role of EECP in the management of cardiovascular disease, the Company has continued to invest in clinical research in areas in which EECP may provide benefit.

On the financial front, despite a flattening of sales growth in recent quarters, Vasomedical posted a third consecutive profitable year marked by continued double-digit revenue growth. Revenues grew 27 percent, units shipped year-over-year increased 23 percent and the Company continued to maintain attractive margins. At the close of fiscal year 2002, Vasomedical's global installed base exceeded 600 systems. The Company continued to strengthen its position both as a leader in cardiovascular disease management and as the leading provider of external counterpulsation therapy systems and services. Looking forward, we believe that ample opportunity exists to expand the market for EECP treatment as we advocate the therapy for the management of patients with symptomatic coronary artery disease and begin to capitalize on the emerging use of EECP in the management of patients with CHF. There is a significant unmet clinical need in the treatment of heart failure, and little consensus on optimal treatment strategies beyond pharmacological management. Heart failure, which affects nearly 22 million patients worldwide, is the most frequent cause of hospitalization for those over 65 years of age. It is the single biggest drain on the Medicare system today; the cost to treat CHF patients in the United States is estimated to be in excess of $40 billion annually.

Ample opportunity exists to expand the market for EECP treatment as we advocate the therapy for the management of patients with symptomatic coronary artery disease and begin to capitalize on the emerging use of EECP in the management of patients with CHF.

The Company's marketing strategy is focused on expanding the number of commercial third-party payers reimbursing for EECP and obtaining broader Medicare coverage for the therapy, including coverage for patients with CHF. It is also focused on increasing awareness of EECP among the cardiology and primary care physician communities, as well as on educational efforts targeted at the cardiology community.

Reimbursement continues to be a critical driver of our business. As such, the Company is dedicating significant resources to establish and broaden favorable coverage policies that include CHF. This past summer, Vasomedical met with representatives from the Centers for Medicare and Medicaid Services (CMS) to review the FDA decision and advise them on the progress of the PEECH™ (Prospective Evaluation of EECP in Congestive Heart Failure) trial. This large, randomized 180-patient study is designed to further evaluate the efficacy of EECP in CHF. The results of this trial will be one of the keys to expanding reimbursement coverage, since both Medicare and third-party commercial insurers attach significant importance to the data generated by such large-scale trials; and it is the Company's goal to broaden its existing coverage policies. We expect that as data from the PEECH trial and other clinical evidence accumulate, and the results of various ongoing and planned economic outcomes analyses become known, the current coverage policies will be modified to include patients with CHF beyond those experiencing anginal symptoms. We anticipate this process to take two to three years. It is expected that this will create opportunities for market expansion beginning in fiscal year 2004. In the meantime, CMS has acknowledged coverage for patients who have angina or angina-equivalent symptoms in conjunction with CHF.

The cost to treat CHF patients in the United States is estimated to be in excess of $40 billion annually.

In the coming months, Vasomedical will launch a targeted EECP awareness campaign in several leading medical journals. This campaign will complement the Company's presence at major scientific conferences and other efforts to educate physicians about EECP and, in particular, the therapy's role in the management of symptomatic coronary artery disease and CHF. As part of the Company's professional outreach program, Vasomedical supported a special Continuing Medical Education (CME) symposium on the use of EECP in CHF at the Annual Scientific Sessions of the Heart Failure Society of America (HFSA) in September 2002. During this past fiscal year, Vasomedical became a corporate sponsor of the HFSA, increasing its presence among heart failure specialists and strengthening its relationship with this key subset of the cardiology community.

John C.K. Hui, PhD
Senior Vice President
and Chief Technology Officer

Joseph A. Giacalone
Chief Financial Officer and Secretary

Harold Kaefer
Vice President, Engineering and Manufacturing

In addition to efforts aimed at increasing awareness of EECP among the medical community, Vasomedical will pilot a patient-focused EECP awareness program in select regions of the United States to generate increased patient volume at EECP provider sites. These initiatives will reflect the successful experience of our customers, particularly the independent centers, who routinely incorporate patient awareness programs in their marketing efforts.

Vasomedical's reimbursement strategy, along with its professional outreach and direct-to-patient awareness programs, will lay the foundation for the Company's future success in expanding the market and exploiting the CHF opportunity. These programs will require a substantial investment over the next several quarters.

Vasomedical continues to play a leadership role in the area of cardiovascular research, and is committed to advancing the science surrounding EECP's therapeutic role and understanding its mechanism of action. Approximately 30 abstracts and scientific manuscripts were presented or published this past year, including a growing body of data suggesting that EECP triggers a series of favorable biochemical responses resulting in sustained patient improvement many months following the completion of EECP therapy. A follow-on study to MUST-EECP, the first large-scale randomized trial on EECP for patients with angina, showed dramatic improvements in health-related quality of life at one year post-therapy. Additionally, a study published in the July/August 2002 issue of the journal **Congestive Heart Failure**, established the rationale for considering EECP in the treatment of CHF patients. This study of 26 patients demonstrated that EECP produces significant improvements in oxygen utilization, exercise capacity and health-related quality of life parameters six months post-treatment.

The Company will continue to support its international business, and build upon this past year's expansion of the market for EECP systems. We began promoting the CHF

Vasomedical is focused on expanding the number of commercial third-party payers reimbursing for EECP and obtaining broader Medicare coverage for the therapy, including coverage for patients with CHF.

CJ McGroarty IV
Vice President, Sales

Thomas R. Varricchione
Vice President, Clinical and Regulatory Affairs

Gregory D. Cash
President and Chief Operating Officer

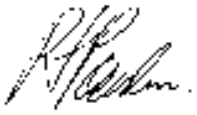
opportunity in Europe at the European Society of Cardiology meeting in Berlin last September, and plan to maintain a presence in these markets via our existing distributor relationships.

Photios T. Paulson, a member of Vasomedical's Board of Directors, assumed the role of Chief Executive Officer for the Company in October 2002. During the same month, Vasomedical appointed Gregory D. Cash as its President and Chief Operating Officer. Mr. Cash brings nearly 25 years of experience in the medical device industry to his position at Vasomedical. He most recently served as Corporate Vice President of Datascope Corporation and President of its wholly-owned subsidiary, Intervascular Inc. The addition of these two individuals strengthens Vasomedical's management team, laying a strong base for execution of the Company's growth strategy.

In closing, we wish to thank our employees and stockholders who have been part of our growth and success, and welcome those of you who have joined us in the past year. We would also like to acknowledge our patients, along with their families and physicians, who have put their trust in us. Their lives, health and happiness are at the core of all we do, and are the driving forces behind our commitment to continue to strengthen our leadership role in the management of chronic cardiovascular disease.

Sincerely,

Abraham E. Cohen
Chairman of the Board



Photios T. Paulson
Chief Executive Officer

(left) Abraham E. Cohen
Chairman of the Board

(right) Photios T. Paulson
Chief Executive Officer

"In my practice, I have seen first-hand the benefits of EECP therapy in patients with chronic ischemic heart disease and heart failure, and I believe the therapy should be considered by every cardiologist treating these patients."

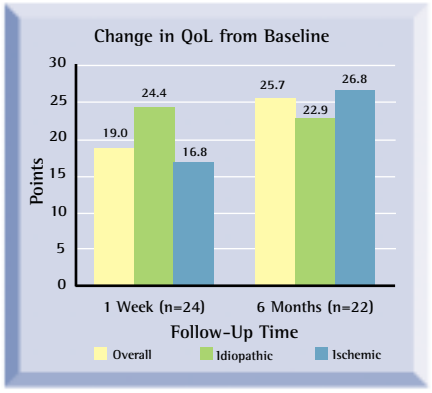
John E. Strobeck, MD, PhD
Co-Editor in Chief, **Congestive Heart Failure**
and Medical Director of The Heart-Lung Center
Hawthorne, NJ

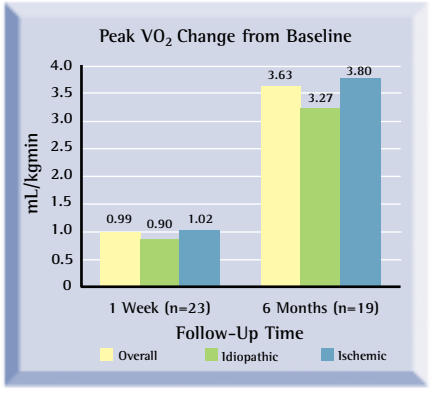
Vasomedical...dedicated to advancing EECP and its clinical applications

In collaboration with physicians and top medical centers around the country, Vasomedical is continuously working to expand the clinical utility of EECP therapy. The Company strongly encourages the submission of EECP-related studies and analyses by investigators at these centers. This past year alone, some 30 abstracts and scientific manuscripts were presented at major conferences or published in peer-reviewed journals.

Recently, the FDA granted clearance for the use of EECP in the treatment of CHF. Patients with CHF present an enormous challenge to physicians and the need for effective treatment options beyond the use of pharmacotherapy to manage patients with this debilitating condition represents a significant unmet clinical need. EECP provides a welcome and much needed new treatment strategy for managing these patients.

The Company has reprioritized its objectives to take maximum advantage of the earlier than expected market clearance including obtaining specific reimbursements from Medicare and other insurers for CHF.





A study of 26 patients with either ischemic or idiopathic cardiomyopathy published in the July/August 2002 issue of the journal **Congestive Heart Failure**, showed that EECP produced significant improvements in oxygen utilization, exercise capacity and health-related quality of life.

"Despite the conventional treatment modalities, heart failure is still a major burden in healthcare management. Recent research suggests that EECP is our chance to lessen this burden in a safe and effective way."

Z. Ozlem Soran, MD
Assistant Professor of Medicine
Director of EECP Research Lab
Cardiovascular Institute
University of Pittsburgh Medical Center
Pittsburgh, PA

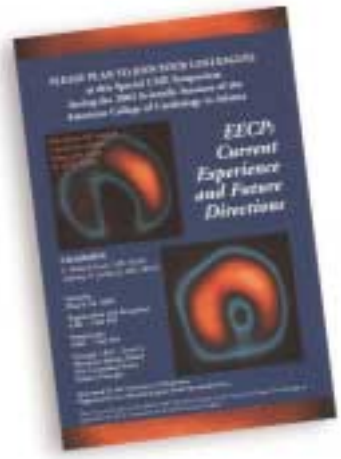
"Based on preliminary data, EECP is safe and well tolerated in patients with congestive heart failure. This offers us an additional treatment option for the thousands of patients who suffer from this disorder."

Erminia M. Guarneri, MD
Scripps Center for Integrative Medicine
Interventional Cardiology
Division of Cardiovascular Diseases
La Jolla, CA

Vasomedical...committed to clinical education

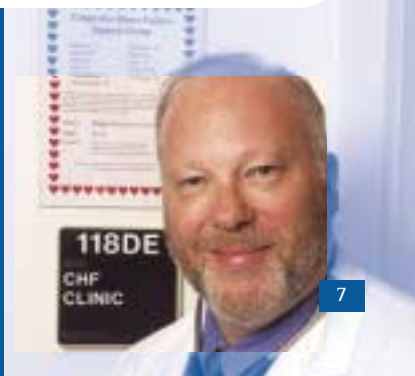
The Company supports a variety of peer-to-peer educational initiatives. This past spring, Vasomedical supported, for the first time, a large-scale CME symposium sponsored by the University of Minnesota prior to the 2002 Scientific Sessions of the American College of Cardiology in Atlanta. The faculty for this symposium, comprised of thought leaders in EECP from around the United States, presented a review of currently accepted treatment strategies for patients with symptomatic coronary artery disease and discussed the role of EECP in today's clinical setting.

Vasomedical supported another CME symposium in September 2002 on the use of EECP in CHF at the Annual Scientific Sessions of the HFSA. During fiscal year 2002, Vasomedical became a corporate sponsor of the HFSA including the Society's fellowship programs.



"EECP offers the opportunity to provide an additional heart failure therapy that could improve how thousands of heart failure patients feel and, at the same time, to be able to do that safely and noninvasively, is an enormous benefit that must not go unexplored."

Marc A. Silver, MD
Clinical Professor and Chairman
Department of Medicine
Director, Heart Failure Institute
Christ Hospital and Medical Center
Oaklawn, IL



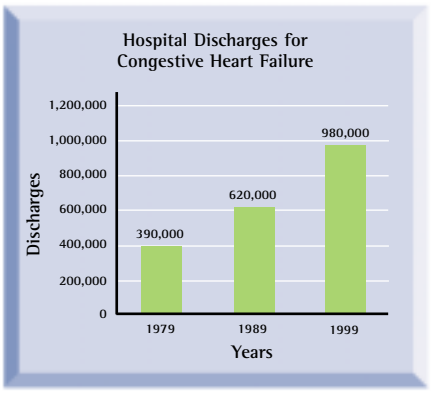
"I feel much better thanks to EECP therapy—I can resume a normal life. I play basketball with my grandsons, work on my car and enjoy my family time. EECP therapy has restored my quality of life."

David Rusnak, 53 year-old patient

Vasomedical...returning heart patients to active and productive lives

EECP has helped thousands of heart patients lead happier and more productive lives by reducing or eliminating their angina or other symptoms of coronary artery disease, dramatically improving their functional ability and quality of life. Many patients have also been able to reduce or eliminate their dependence on nitroglycerine.

EECP has also now been recognized as having a role in the management of CHF. CHF affects nearly 22 million people worldwide and is the most frequent cause of hospitalization for those 65 years of age or older.



Data Source: American Heart Association,
2002 Heart and Stroke Statistical Update

Some patients first come to learn about EECP therapy over the airwaves. Deborah Braverman, MD, Medical Director of Vital Heart in Philadelphia, discusses treatment options for patients with her listening audience.

"Before EECP therapy, I couldn't do the things I wanted to do—the congestive heart failure attacked me both physically and emotionally. After EECP, I have quality back in my life and I can do almost anything. I can ride my bike, mow the lawn. My family has always been there for me and EECP therapy made it easier for them too."

Larry E. Lowers, 54 year-old patient

Selected Financial Data

The following table summarizes selected financial data for each of the five years ended May 31, 2002 as derived from the Company's audited consolidated financial statements. These data should be read in conjunction with the consolidated financial statements of the Company, related notes and other financial information.

	Year ended May 31,				
	2002	2001	2000	1999	1998
Statements of Earnings					
Revenues	$34,830,471	$27,508,338	$13,673,632	$ 6,024,263	$ 5,225,064
Cost of sales and services	10,538,731	7,910,359	3,277,700	2,035,578	1,654,979
Gross profit	24,291,740	19,597,979	10,395,932	3,988,685	3,570,085
Selling, general & administrative expenses	13,686,958	11,634,965	7,383,567	6,207,924	5,941,675
Research and development expenses	5,112,258	2,554,470	1,413,464	706,934	1,595,970
Provision for doubtful accounts	1,304,000	325,000	400,000	–	–
Interest and financing costs	98,140	48,294	7,302	11,880	4,057
Interest and other income, net	(249,722)	(201,992)	(99,317)	(115,064)	(169,422)
	19,951,634	14,360,737	9,105,016	6,811,674	7,372,280
Earnings (loss) before income taxes	4,340,106	5,237,242	1,290,916	(2,822,989)	(3,802,195)
Income tax (expense) benefit, net	(1,554,000)	6,457,108	400,000	–	–
Net earnings (loss)	2,786,106	11,694,350	1,690,916	(2,822,989)	(3,802,195)
Deemed dividend on preferred stock	–	–	–	(864,000)	(1,132,000)
Preferred stock dividend requirement	–	–	(94,122)	(205,163)	(96,717)
Earnings (loss) applicable to common stockholders	$ 2,786,106	$11,694,350	$ 1,596,794	$(3,892,152)	$(5,030,912)
Net earnings (loss) per common share - basic	$ .05	$ .21	$ .03	$ (.08)	$ (.11)
- diluted	$ .05	$ .20	$ .03	$ (.08)	$ (.11)
Weighted average common shares outstanding - basic	57,251,035	56,571,402	52,580,623	49,371,574	47,873,711
- diluted	59,468,092	59,927,199	57,141,949	49,371,574	47,873,711
Balance Sheet Information					
Working capital	$17,225,434	$16,214,655	$ 7,380,236	$ 2,174,774	$ 5,046,202
Total assets	$41,418,258	$36,518,974	$10,588,962	$ 5,198,172	$ 7,345,246
Long-term debt	$ 1,072,716	$ 1,108,593	$ –	$ –	$ –
Stockholders' equity [1]	$31,602,604	$28,508,729	$ 7,943,770	$ 3,153,533	$ 5,752,993

(1) No cash dividends were declared during any of the above periods.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

Fiscal Years Ended May 31, 2002 and 2001

The Company generated revenues from the sale and lease of EECP® systems of $34,830,000 and $27,508,000 for fiscal 2002 and fiscal 2001, respectively, representing a 27% increase. The Company generated earnings before income taxes of $4,340,000 and $5,237,000 for fiscal 2002 and fiscal 2001, respectively. The Company reported net earnings of $2,786,000 and $11,694,000 for fiscal 2002 and fiscal 2001, respectively, after recognition of an income tax provision (benefit) of $1,554,000 and $(6,457,000), respectively.

The number of cardiology practices and hospitals interested in becoming providers of EECP therapy has increased following the announcement by the Centers for Medicare and Medicaid Services (CMS) (formerly the Health Care Financing Administration (HCFA)) in February 1999 of its decision to extend Medicare coverage nationally to the Company's noninvasive, outpatient treatment for coronary artery disease. CMS is the federal agency that administers the Medicare program for approximately 39 million beneficiaries. In addition, the results of the Company's multicenter, prospective, randomized, blinded, controlled clinical study of EECP (MUST-EECP) were published in the June 1999 issue of the *Journal of the American College of Cardiology*. Interest in EECP therapy has also been spurred by the announcement of the results of six-month, twelve-month and twenty-four month post-treatment outcomes reported by the International EECP Patient Registry, as well as numerous other studies reported and presented at major scientific meetings, including the American Heart Association (AHA) and the American College of Cardiology (ACC) annual meetings.

Effective January 1, 2002, CMS approved an additional increase of 7%, raising the average Medicare payment to $153 per hourly session, or $5,355 for a full course of therapy. These events led to an increased demand for EECP therapy and EECP equipment and, consequently, to revenue growth overall. Pursuant to contractual arrangements with two customers, the Company has sold equipment under sales-type leases. In fiscal 2002, revenues of $4,187,000 were reported from equipment sold under sales-type leases. In fiscal 2002, the Company shipped 263 systems (a 23% increase over the prior year) under various domestic and non-domestic commercial arrangements, including direct sales, rental and "fee-per-use" placements, sales-type leases and sales to foreign distributors. Revenues from non-domestic business were $2,725,000, accounting for nearly 8% of total revenues compared to $1,441,000, or 5%, in fiscal 2001.

The Company continues to be optimistic about its future. In June 2002, the Company announced that all three of its models of the EECP system had been granted a 510(k) market clearance from the Food and Drug Administration (FDA) for a new indication for the treatment of congestive heart failure. Congestive heart failure afflicts more than 5 million people in the United States alone, with more than 550,000 new patients diagnosed every year. It is the single most expensive disease state in the nation, accounting for more than $40 billion in direct and indirect medical costs.

Gross profit margins for fiscal 2002 and 2001 were 70% and 71%, respectively. Gross profits are dependent on a number of factors, particularly the mix of EECP units sold, rented or placed during the period, the ongoing costs of servicing such units, and certain fixed period costs, including facilities, payroll and insurance. Gross margins are furthermore affected by the location of the Company's customers (including non-domestic business or distributorship arrangements which, for discounted equipment purchase prices, co-invest in establishing a market for EECP equipment) and the amount and nature of training and other initial costs required to place the EECP system in service for customer use. Consequently, the gross profit realized during the current period may not be indicative of future margins. The decrease in gross profit margin for fiscal 2002 compared to 2001 was primarily attributable to a change in the product mix now favoring the new, but more costly, Model TS3 system manufactured in Westbury, NY. Management believes that the increased production costs of TS3 will be offset in the future by manufacturing efficiencies and engineering initiatives toward further product cost reduction. In addition, gross profit margin was further affected by the change in sales mix, inclusive of an 89% increase in revenues from non-domestic business in fiscal 2002 which, as described above, is less profitable than the Company's domestic business.

Selling, general and administrative (SG&A) expenses for fiscal 2002 and 2001 were $13,687,000 (39% of revenues) and $11,635,000 (42% of revenues), respectively. The Company has been effectively leveraging its SG&A expenses as a percentage of sales, decreasing by 3%. The increases in SG&A expenses, on an absolute basis, from the comparable prior fiscal year resulted primarily from increases in personnel in sales and marketing functions, increases in selling and marketing expenses (including commissions) related to increased revenues, as well as increases in insurance and other administrative expenses.

In fiscal 2002, the Company charged $1,304,000 to its provision for doubtful accounts, substantially increasing reserves primarily as a result of extended credit terms offered to certain domestic and international customers, as well as a valuation reserve in connection with long-term financing receivables generated by equipment sold under sales-type leases.

Research and development (R&D) expenses of $5,112,000 (15% of revenues) for fiscal 2002 increased by $2,558,000, or 100%, from the prior fiscal year of $2,554,000 (9% of revenues). The increase relates primarily to expenses incurred for the PEECH clinical trial in heart failure (which received FDA approval in July 2000 and began treating patients in March 2001), the initiation of other clinical studies and initiatives, as well as continued product design and development costs (including an increase in engineering and other personnel). The Company's newly developed EECP system, Model TS3, received FDA

510(k) clearance to market in December 2000 and was commercially available for sale in the fourth quarter of fiscal 2001. The Company intends to invest approximately 12%-14% of revenues in product development and clinical trials in fiscal 2003 to further expand the clinical applications of EECP, including, but not limited to, heart failure, diabetes disease management and acute coronary syndromes.

In fiscal 2002, the Company recorded a provision for income taxes of $1,554,000, inclusive of $39,000 in current tax expense principally resulting from state taxes. This is in contrast to a deferred tax benefit reported in fiscal 2001 of $6,457,000 resulting principally from a change in the deferred tax valuation allowance.

The increase in interest income in fiscal 2002 is the direct result of interest income reported on equipment sold under sales-type leases, offset by the decrease in the average cash balances invested during the year, as well as declining interest rates this year over last year.

The increase in interest expense over the prior fiscal year is primarily due to interest payments on loans secured for the purchase of the Company's headquarters and operating facility in November 2000, as well as working capital borrowings under the Company's revolving secured credit facility.

Fiscal Years Ended May 31, 2001 and 2000

The Company generated revenues from the sale and lease of EECP systems of $27,508,000 and $13,674,000 for fiscal 2001 and fiscal 2000, respectively, representing a 101% increase. The Company generated earnings before income taxes of $5,237,000 and $1,291,000 for fiscal 2001 and fiscal 2000, respectively. The Company generated earnings of $11,694,000 and $1,597,000 for fiscal 2001 and fiscal 2000, respectively (after recognition of a deferred income tax benefit of $6.6 million for fiscal 2001 and after deducting $94,000 in preferred stock dividend requirements related to its June 1997 financing for fiscal 2000).

Revenue growth in the prior fiscal period (fiscal 2000) was initially hindered because local Medicare contractors established inappropriate payment levels that did not take into account the full value of the resources health care providers must deploy to deliver EECP therapy. Consequently, in November 1999, CMS created a specific code for external counterpulsation therapy and established a nationally applicable allowable charge, which became effective on January 1, 2000. The allowable charge under the new code was based upon a preliminary determination of Relative Value Units (RVUs) assigned by CMS to the resources needed for the administration of the therapy. Certain patients may require additional services, such as evaluation and management, which may be billed separately. This resulted in a standard charge of $4,550 for a full course of therapy, which typically involves 35 one-hour outpatient sessions. The assigned code now allows EECP providers to bill Medicare electronically, substantially reducing the process for receiving reimbursement. Moreover, in light of these new payment instructions, local Medicare contractors no longer have the responsibility of establishing reimbursement rates. Beginning August 1, 2000, Medicare coverage was extended to include EECP treatment received on an outpatient basis at hospitals and outpatient clinics under the new APC (Ambulatory Payment Classification) system. The national average payment rate approximated $150 per session. Effective January 1, 2001, CMS approved an 11% increase in the reimbursement rate for EECP therapy which raised the average Medicare payment from $130 to $144 per hourly session, or $5,040 for a full course of therapy. These events led to an increased demand for EECP therapy and EECP equipment and, consequently, to revenue growth overall, as well as an increase in the number of systems placed under fee-per-use arrangements with certain providers.

In fiscal 2001, the Company shipped 168% more systems over the prior year under various domestic and non-domestic commercial arrangements, including direct sales, rental and "fee-per-use" placements and sales to foreign distributors. Revenues from non-domestic business were $1,441,000, accounting for 5% of total revenues compared to $155,000 or 1%, in 2000.

Gross profit margins for fiscal 2001 and 2000 were 71% and 76%, respectively. Gross profits are dependent on a number of factors, particularly the mix of EECP units sold and rented during the period, the mix of EECP models sold, the ongoing costs of servicing such units, and certain fixed period costs, including facilities, payroll and insurance. Gross margins are furthermore affected by the location of the Company's customers (including non-domestic business or distributorship arrangements which, for discounted equipment purchase prices, co-invest in establishing a market for EECP equipment) and the amount and nature of training and other initial costs required to place the EECP system in service for customer use. Consequently, the gross profit realized during the current period may not be indicative of future margins. The decrease in gross profit for fiscal 2001 was partially attributable to the increased manufacturing costs of its Model TS3 system manufactured in Westbury, NY. Management believes that these increased costs will be offset in the future by manufacturing efficiencies and the Company is continually engaged in a product cost reduction program.

Selling, general and administrative (SG&A) expenses for fiscal 2001 and 2000 were $11,635,000 and $7,384,000, respectively. The increase in SG&A expenses of $4,251,000 from the comparable prior fiscal year resulted primarily from increases in personnel in sales, marketing and administrative functions, increases in selling and marketing expenses, including commissions, related to increased revenues, as well as increases in insurance and other administrative expenses.

Research and development (R&D) expenses of $2,554,0000, or 9% of revenues, in fiscal 2001 increased by $1,141,000 from the comparable prior year expenses of $1,413,000, or 10% of revenues. The increase relates primarily to continued product design and development costs (including an increase in engineering and other personnel), as well as the initiation of the pivotal study in heart failure (which received FDA approval in July 2000 and began treating patients in March 2001). The Company's newly developed EECP system, Model

TS3, received FDA 510(k) clearance to market in December 2000 and was commercially available for sale in the fourth quarter of fiscal 2001. The Company intends to invest in product development and clinical trials in future periods to further expand the clinical applications of EECP, including, but not limited to, heart failure and diabetes disease management.

In fiscal 2001, the Company recorded a benefit for income taxes of $6,457,000, inclusive of $140,000 in current tax expense principally resulting from the federal alternative minimum tax and a deferred tax benefit of $6,597,000 resulting principally from the change in the valuation allowance. The fiscal 2001 deferred tax benefit does not include the tax benefit associated with the current and prior years' exercises of stock options and warrants, aggregating $7,209,000, which was credited directly to additional paid-in capital in fiscal 2001.

In fiscal 2000, management had established a valuation allowance for a portion of the deferred tax assets based on uncertainties with respect to the Company's ability to generate future taxable income. At May 31, 2000, the valuation allowance primarily related to net operating losses and a $6,165,000 tax benefit from the exercise of stock options and warrants included in the net operating loss carryforward.

As of May 31, 2001, management determined that no valuation allowance was required based upon its financial performance, which was positively affected by the availability of Medicare coverage and reimbursement and the increasing acceptance by the medical community of the Company's cost-effective and noninvasive therapy system. In addition, the Company's assessment of the cardiovascular disease marketplace, which includes favorable patient demographics and unmet clinical needs, provides a substantial economic opportunity and anticipated future earnings stream with respect to current and prospective clinical applications for its products. Ultimate realization of the deferred tax assets is dependent upon the Company generating sufficient taxable income prior to the expiration of the loss carryforwards. Although realization is not assured, management believes it is more likely than not that the net deferred tax assets will be realized. The amount of the deferred tax assets considered realizable, however, could be reduced in the future if estimates of future taxable income during the carryforward period are reduced.

Liquidity and Capital Resources

The Company has financed its fiscal 2002 and 2001 operations primarily from working capital and operating results. At May 31, 2002, the Company had a cash balance of $2,968,000 and working capital of $17,225,000, compared to a cash balance of $3,785,000 and working capital of $16,215,000 at May 31, 2001. The Company's operating activities (used) provided cash of $(2,317,000) and $679,000 for fiscal 2002 and fiscal 2001, respectively. Net cash used in operations during fiscal 2002 consisted primarily of increases in accounts receivable, financing receivables and inventories, offset by increases in accounts payable, accrued expenses and other liabilities. The increase in financing receivables resulted from sales of equipment under sales-type leases, the first such commercial contracts entered into by the Company in fiscal 2002. Cash receipts under sales-type leases are expected over terms ranging between three and six years. The increase in inventories resulted from an increase in finished goods of the Company's Model TS3 system, which began commercial shipments in the fourth quarter of fiscal 2001. The increase in accounts receivable resulted primarily from extended credit terms offered to customers, particularly non-domestic customers, in the current year. The Company's management provides routine oversight with respect to its accounts receivable credit and collection efforts, as well as the procurement of its raw materials and management of finished goods inventory levels. Cash used in operations during fiscal year 2002, particularly as they relate to financing receivables, are not necessarily indicative of the results expected in future years.

Investing activities used net cash of $820,000 and $1,578,000 during fiscal 2002 and fiscal 2001, respectively. In fiscal 2002, the principal use of cash was a $500,000 loan made by the Company, through the issuance of notes to a customer engaged in the establishment of a national network of EECP centers. In fiscal 2001, the principal use of cash was for the purchase of property and equipment, notably the purchase of the Company's headquarters and operating facility.

Financing activities provided cash of $2,319,000 and $1,627,000 during fiscal 2002 and fiscal 2001, respectively. In September 2001, the Company refinanced a $641,667 outstanding short-term note payable (which arose in connection with the November 2000 purchase of the Company's headquarters and operating facility) with the New York Business Development Corporation. This transaction released $641,667 of cash previously restricted as collateral under the original note. The cash restricted as collateral on the second outstanding note for $500,000 was released in January 2002 upon its refinancing. The balance of the financing activities during fiscal 2002 and 2001 consisted primarily from the sale of common stock and receipt of cash proceeds upon the exercise of Company common stock warrants by officers, directors, employees and consultants. In February 2002, the Company increased its existing credit facility to provide for borrowings up to $15,000,000, based upon eligible accounts receivable and raw materials inventory, as defined therein, at the Libor Rate plus 150 basis points. At May 31, 2002, approximately $3,600,000 of the line was available of which there were outstanding borrowings of $1,000,000.

Management believes that its working capital position at May 31, 2002, the availability of its credit facility, and the ongoing commercialization of the EECP system will make it possible for the Company to support its operating expenses and to implement its business plans for at least the next twelve months.

The following table presents the Company's expected cash requirements for contractual obligations outstanding as of May 31, 2002:

	Total	Due in FY 2003	Due in FY 2004-2005	Due in FY 2006-2007	Due Thereafter
Line of Credit (1)	$1,000,000	$1,000,000			
Long-Term Debt	1,119,161	46,445	$103,151	$118,551	$851,014
Operating Leases	226,000	87,000	90,000	49,000	–
Employment Agreements	520,000	270,000	150,000	100,000	–
Purchase Obligations	324,000	324,000	–	–	–
Total Contractual Cash Obligations	$3,189,161	$1,727,445	$343,151	$267,551	$851,014

(1) The Company maintains a revolving credit agreement which provides for borrowings of up to $15,000,000, based upon eligible accounts receivable, as defined therein. Approximately $3,600,000 is available under the revolving credit agreement, of which $1,000,000 is outstanding at May 31, 2002. The revolving credit agreement expires in February 2005.

Effects of Inflation

The Company believes that inflation and changing prices over the past three years have not had a significant impact on our revenue or on our results of operations.

Qualitative and Quantitative Disclosures About Market Risk

The Company is exposed to certain financial market risks, including changes in interest rates. All of the Company's revenue, expenses and capital spending are transacted in US dollars. The Company's exposure to market risk for changes in interest rates relates primarily to our cash and cash equivalent balances, investments in sales-type leases and the line of credit agreement. The majority of our investments are in short-term instruments and subject to fluctuations in US interest rates. Due to the nature of our short-term investments, we believe that there is no material risk exposure.

Critical Accounting Policies

Financial Reporting Release No. 60, which was released by the Securities and Exchange Commission, or SEC, in December 2001, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note A of the Notes to Consolidated Financial Statements includes a summary of the Company's significant accounting policies and methods used in the preparation of our financial statements. In preparing these financial statements, the Company has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. The application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. The Company does not believe there is a great likelihood that materially different amounts would be reported under different conditions or using different assumptions. The Company's critical accounting policies are as follows:

Revenue Recognition

The Company recognizes revenue from the sale of its EECP system in the period in which the Company fulfills its obligations under the sale agreement, including delivery and customer acceptance. The Company has also entered into lease agreements for its EECP system, generally for terms of one year or less, that are classified as operating leases. Revenues from operating leases are recognized on a straight-line basis over the life of the respective leases. Revenues from the sale of extended warranties on the EECP system are recognized on a straight-line basis over the life of the extended warranty, ranging from one year to four years. Deferred revenues relate to extended warranty fees that have been paid by customers prior to the performance of extended warranty services.

The Company follows SFAS No. 13, "Accounting For Leases," for its sales of EECP units under sales-type leases with two customers. In accordance with SFAS No. 13, the Company records the sale and financing receivable at the amount of the minimum lease payment, less unearned interest income, which is computed at the interest rate implicit in the lease, and executory costs. The cost of the EECP unit acquired by the customer is recorded as cost of sales in the same period.

Accounts Receivable/Financing Receivables

Estimates are used in determining our allowance for doubtful accounts based on our historical collections experience, current trends, credit policy and a percentage of our accounts receivable by aging category. In determining these percentages, we look at historical write-offs of our receivables. The Company also looks at the credit quality of its

customer base as well as changes in its credit policies. The Company continuously monitors collections and payments from its customers. While credit losses have historically been within expectations and the provisions established, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has in the past.

In addition, the Company periodically reviews and assesses the net realizability of its receivables arising from sales-type leases. If this review results in a lower estimate of the net realizable value of the receivable, an allowance for the unrealized amount is established in the period in which the estimate is changed.

Inventories

The Company values inventory at the lower of cost or estimated market, cost being determined on a first-in, first-out basis. The Company regularly reviews inventory quantities on hand, particularly raw materials and components, and records a provision for excess and obsolete inventory based primarily on existing and anticipated design and engineering changes to our products as well as forecasts of future product demand.

Warranty Costs

Equipment sold is generally covered by a warranty period of one year. The Company accrues a warranty reserve for estimated costs to provide warranty services. The estimate of costs to service our warranty obligations is based on historical experience and an expectation of future conditions. While these warranty costs have historically been within the Company's expectations and the provisions established, to the extent the Company experiences increased warranty claim activity or increased costs associated with servicing those claims, the warranty accrual will increase, and the Company would experience decreased gross profit.

Income Taxes

Deferred income taxes are recognized for temporary differences between financial statement and income tax bases of assets and liabilities and loss carryforwards for which income tax benefits are expected to be realized in future years. A valuation allowance is established, when necessary, to reduce deferred tax assets to the amount expected to be realized. In estimating future tax consequences, the Company generally considers all expected future events other than an enactment of changes in the tax laws or rates. The deferred tax asset is continually evaluated for realizability. To the extent management's judgment regarding the realization of the deferred tax assets change, an adjustment to the allowance is recorded, with an offsetting increase or decrease, as appropriate, in income tax expense. Such adjustments are recorded in the period in which management's estimate as to the realizability of the asset changed.

Stock Compensation

The Company measures stock-based awards using the intrinsic value method. As described in Note 1, pro forma disclosure of the effect on net earnings and net earnings per common share has been computed as if the fair value-based method had been applied in measuring compensation expense.

Recently Issued Accounting Standards

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"). SFAS No. 144 supersedes SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and Accounting Principles Board Opinion No. 30, "Reporting Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." This statement retains the fundamental provisions of SFAS No. 121 for recognition and measurement of impairment, but amends the accounting and reporting standards for segments of a business to be disposed of. The new rules are effective for the Company on June 1, 2002. The Company is currently evaluating the impact of the adoption of SFAS No. 144, which the Company expects will not be material.

Forward-Looking Statements

Except for historical information contained in this Annual Report, the matters discussed are forward-looking statements that involve risks and uncertainties. When used herein, words such as "anticipate", "believe", "estimate", "expect" and "intend" 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 impact of competitive products and pricing; capacity and supply constraints or difficulties; product development, commercialization or technological difficulties; the regulatory and trade environment; and the risk factors reported from time to time in the Company's SEC reports. The Company undertakes no obligation to update forward-looking statements as a result of future events or developments.

Consolidated Balance Sheets

	May 31, 2002	May 31, 2001
Assets		
Current Assets		
Cash and cash equivalents	$ 2,967,627	$ 3,785,456
Restricted cash	–	1,141,667
Accounts receivable, net of an allowance for doubtful accounts of $1,099,687 and $545,000 at May 31, 2002 and 2001, respectively	12,682,725	9,731,749
Inventories	4,902,121	4,367,943
Deferred income taxes	3,033,000	2,908,000
Financing receivables, net	633,786	–
Other current assets	627,243	443,887
Total current assets	24,846,502	22,378,702
Property and Equipment, net	3,252,030	2,606,037
Capitalized Cost in Excess of Fair Value of Net Assets Acquired, net of accumulated amortization of $1,349,613 at May 31, 2001	–	142,085
Financing Receivables, net	2,941,587	–
Notes Receivable	512,329	–
Deferred Income Taxes	9,658,000	11,298,000
Other Assets	207,810	94,150
	$41,418,258	$36,518,974
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts payable and accrued expenses	$ 3,645,846	$ 4,041,243
Current maturities of long-term debt and notes payable	1,046,445	33,074
Sales tax payable	732,362	532,548
Deferred revenues	272,000	–
Accrued warranty and customer support expenses	588,334	567,000
Accrued professional fees	362,083	320,854
Accrued commissions	973,998	669,328
Total current liabilities	7,621,068	6,164,047
Long-Term Debt	1,072,716	1,108,593
Accrued Warranty Costs	402,666	488,000
Deferred Revenues	719,204	243,151
Other Long-Term Liabilities	–	6,454
Commitments and Contingencies		
Stockholders' Equity		
Preferred stock, $.01 par value; 1,000,000 shares authorized; none issued and outstanding	–	–
Common stock, $.001 par value; 110,000,000 shares authorized; 57,309,120 and 57,195,453 shares at May 31, 2002 and 2001, respectively, issued and outstanding	57,309	57,195
Additional paid-in capital	50,116,148	49,808,493
Accumulated deficit	(18,570,853)	(21,356,959)
	31,602,604	28,508,729
	$41,418,258	$36,518,974

The accompanying notes are an integral part of these statements.

Consolidated Statements of Earnings

	Year ended May 31,		
	2002	2001	2000
Revenues			
Equipment sales	$29,304,349	$26,912,373	$13,120,144
Equipment rentals and services	1,339,113	595,965	553,488
Equipment sold under sales-type leases	4,187,009	–	–
	34,830,471	27,508,338	13,673,632
Cost of sales and services	10,538,731	7,910,359	3,277,700
Gross profit	24,291,740	19,597,979	10,395,932
Expenses			
Selling, general and administrative	13,686,958	11,634,965	7,383,567
Research and development	5,112,258	2,554,470	1,413,464
Provision for doubtful accounts	1,304,000	325,000	400,000
Interest and financing costs	98,140	48,294	7,302
Interest and other income, net	(249,722)	(201,992)	(99,317)
	19,951,634	14,360,737	9,105,016
Earnings Before Income Taxes	4,340,106	5,237,242	1,290,916
Income tax (expense) benefit, net	(1,554,000)	6,457,108	400,000
Net Earnings	2,786,106	11,694,350	1,690,916
Preferred stock dividend requirement	–	–	(94,122)
Earnings Applicable to Common Stockholders	$ 2,786,106	$11,694,350	$ 1,596,794
Net earnings per common share			
- basic	$ .05	$ .21	$ .03
- diluted	$ .05	$ .20	$ .03
Weighted average common shares outstanding			
- basic	57,251,035	56,571,402	52,580,623
- diluted	59,468,092	59,927,199	57,141,949

The accompanying notes are an integral part of these statements.

Consolidated Statement of Changes in Stockholders' Equity

	Preferred stock		Common stock		Additional paid-in capital	Accumulated deficit	Total stockholders' equity
	Shares	Amount	Shares	Amount			
Balance at June 1, 1999	175,000	$1,750	50,402,687	$50,403	$37,749,483	$(34,648,103)	$3,153,533
Conversion of preferred stock	(175,000)	(1,750)	3,095,612	3,096	(1,346)		–
Exercise of options and warrants			2,169,831	2,169	2,816,542		2,818,711
Preferred stock dividend requirement						(94,122)	(94,122)
Common stock issued in lieu of preferred stock dividends			253,200	253	287,479		287,732
Stock options granted for services					87,000		87,000
Net earnings						1,690,916	1,690,916
Balance at May 31, 2000	–	–	55,921,330	55,921	40,939,158	(33,051,309)	7,943,770
Exercise of options and warrants			1,274,123	1,274	1,625,335		1,626,609
Stock options granted for services					35,000		35,000
Tax benefit of stock options and warrants exercised in the current and prior years					7,209,000		7,209,000
Net earnings						11,694,350	11,694,350
Balance at May 31, 2001	–	–	57,195,453	57,195	49,808,493	(21,356,959)	28,508,729
Exercise of options and warrants			113,667	114	199,529		199,643
Stock options granted for services					50,126		50,126
Tax benefit of stock options and warrants exercised in the current year					58,000		58,000
Net earnings						2,786,106	2,786,106
Balance at May 31, 2002	–	$ –	57,309,120	$57,309	$50,116,148	$(18,570,853)	$31,602,604

The accompanying notes are an integral part of this statement.

Consolidated Statements of Cash Flows

	Year ended May 31,		
	2002	2001	2000
Cash flows from operating activities			
Net earnings	$ 2,786,106	$ 11,694,350	$ 1,690,916
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities			
Depreciation and amortization	962,167	587,541	483,627
Provision for doubtful accounts, net of write-offs	904,687	145,000	400,000
Reserve for inventory obsolescence	30,000	150,000	–
Deferred income taxes	1,573,000	(6,597,000)	(400,000)
Stock options granted for services	50,126	35,000	87,000
Changes in operating assets and liabilities			
Accounts receivable	(3,855,663)	(5,043,939)	(3,647,378)
Financing receivables, net	(3,575,373)	–	–
Inventories	(1,694,198)	(4,460,572)	(281,337)
Other current assets	(183,356)	35,380	(301,555)
Other assets	(142,062)	(90,251)	15,077
Accounts payable, accrued expenses and other current liabilities	443,649	3,833,781	630,164
Other liabilities	384,265	389,605	164,000
	(5,102,758)	(11,015,455)	(2,850,402)
Net cash provided by (used in) operating activities	(2,316,652)	678,895	(1,159,486)
Cash flows from investing activities			
Issuance of notes	(500,000)	–	–
Purchase of property and equipment	(319,981)	(1,578,415)	(279,033)
Net cash used in investing activities	(819,981)	(1,578,415)	(279,033)
Cash flows from financing activities			
Proceeds from notes	2,141,667	1,141,667	–
Payments on notes	(1,164,173)	–	–
Restricted cash	1,141,667	(1,141,667)	–
Proceeds from exercise of options and warrants	199,643	1,626,609	2,818,711
Net cash provided by financing activities	2,318,804	1,626,609	2,818,711
Net Increase (Decrease) in Cash and Cash Equivalents	(817,829)	727,089	1,380,192
Cash and cash equivalents - beginning of year	3,785,456	3,058,367	1,678,175
Cash and cash equivalents - end of year	$ 2,967,627	$ 3,785,456	$ 3,058,367
Non-cash investing and financing activities were as follows:			
Issuance of common stock in lieu of preferred dividends			$ 94,122
Inventories transferred to property and equipment attributable to operating leases, net	$ 1,130,020	$ 849,613	$ 31,554
Supplemental disclosures:			
Interest paid	$ 98,139	$ 48,294	$ 7,302
Income taxes paid	$ 304,263	$ 10,749	$ 9,224

The accompanying notes are an integral part of these statements.

Notes to Consolidated Financial Statements

May 31, 2002, 2001 and 2000

NOTE A - BUSINESS ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company was incorporated in Delaware in July 1987. During fiscal 1996, the Company commenced the commercialization of its EECP® enhanced external counterpulsation system ("EECP"), a microprocessor-based medical device for the noninvasive, outpatient treatment of patients with cardiovascular disease. EECP is marketed worldwide to hospitals, clinics and other cardiac health care providers. To date, a significant portion of the Company's revenues have been generated from customers in the United States.

A summary of the significant accounting policies consistently applied in the preparation of the consolidated financial statements follows:

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary and its majority-owned subsidiary. Significant intercompany accounts and transactions have been eliminated.

Inventories

Inventories are stated at the lower of cost or market; cost is determined using the first-in, first-out method.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is provided over the estimated useful lives of the assets, which range from three to thirty-nine years, on a straight-line basis. Accelerated methods of depreciation are used for tax purposes. Leasehold improvements are amortized over the useful life of the related leasehold improvement or the life of the related lease, whichever is less.

Capitalized Cost in Excess of Fair Value of Net Assets Acquired

The capitalized cost in excess of the fair value of the net assets acquired ("goodwill") was being amortized on a straight-line basis over a period of seven years. The goodwill was fully amortized at May 31, 2002 and written off.

Revenue Recognition

The Company recognizes revenue from the sale of its EECP system in the period in which the Company fulfills its obligations under the sale agreement, including delivery and customer acceptance. The Company has also entered into lease agreements for its EECP system, generally for terms of one year or less, that are classified as operating leases. Revenues from operating leases are recognized on a straight-line basis over the life of the respective leases. Revenues from the sale of extended warranties on the EECP system are recognized on a straight-line basis over the life of the extended warranty, ranging from one year to four years. Deferred revenues relate to extended warranty fees that have been paid by customers prior to the performance of extended warranty services.

The Company follows SFAS No. 13, "Accounting For Leases," for its sales of EECP units under sales-type leases with two customers. In accordance with SFAS No. 13, the Company records the sale and financing receivable at the amount of the minimum lease payment, less unearned interest income, which is computed at the interest rate implicit in the lease, and executory costs. The cost of the EECP unit acquired by the customer is recorded as cost of sales in the same period.

In addition, the Company periodically reviews and assesses the net realizability of its receivables arising from sales-type leases. If this review results in a lower estimate of the net realizable value of the receivable, an allowance for the unrealized amount is established in the period in which the estimate is changed.

Concentrations of Credit Risk

The Company markets the EECP system principally to cardiologists, hospitals, clinics and other health care providers. The Company performs credit evaluations of its customers' financial condition and, as a consequence, believes that its receivable credit risk exposure is limited. Receivables are generally due within 60-90 days. (See Note E.)

Warranty Costs

The Company provides for a warranty period on its EECP system. The Company accounts for estimated warranty costs at the time the related revenue is earned. As the Company's experience with respect to the commercial use of the EECP system is limited, revisions to the Company's warranty cost estimates may be necessary in the future.

Research and Development

Research and development costs are expensed as incurred.

Income Taxes

Deferred income taxes are recognized for temporary differences between financial statement and income tax bases of assets and liabilities and loss carryforwards for which income tax benefits are expected to be realized in future years. A valuation allowance is established, when necessary, to reduce deferred tax assets to the amount expected to be realized. In estimating future tax consequences, the Company generally considers all expected future events other than an enactment of changes in the tax laws or rates. The deferred tax asset is continually evaluated for realizability. To the extent management's judgment regarding the realization of the deferred tax assets change, an adjustment to the allowance is recorded, with an offsetting increase or decrease, as appropriate, in income tax expense. Such adjustments are recorded in the period in which management's estimate as to the realizability of the asset changed.

Shipping and Handling Costs

The Company includes all shipping and handling expenses incurred as a component of cost of sales.

Fair Value of Financial Instruments
The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturities of the instruments. The fair value of the financing receivables approximate fair value as they are discounted using the interest rates implicit in the lease. The carrying amounts of notes payable and notes receivable approximate their fair values as the interest rates of these instruments approximate the interest rates available on instruments with similar terms and maturities.

Use of Estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. These estimates and assumptions relate to estimates of collectibility of accounts receivable, the realizability of deferred tax assets, and the adequacy of inventory and warranty reserves. Actual results could differ from those estimates.

Net Earnings Per Common Share
Basic earnings per common share are computed by dividing net earnings available to common stockholders by the weighted average number of shares outstanding during the period. Diluted earnings per common share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock.

Stock Compensation
The Company measures stock-based awards using the intrinsic value method. As described in Note H, pro forma disclosure of the effect on net earnings and net earnings per common share has been computed as if the fair value-based method had been applied in measuring compensation expense.

Statements of Cash Flows
The Company considers highly liquid temporary cash investments with an original maturity of three months or less to be cash equivalents. Cash equivalents consist principally of money market funds. The market value of the cash equivalents approximates cost.

Impact of New Accounting Pronouncements
In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"). SFAS No. 144 supersedes SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and Accounting Principles Board Opinion No. 30, "Reporting Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." This statement retains the fundamental provisions of SFAS No. 121 for recognition and measurement of impairment, but amends the accounting and reporting standards for segments of a business to be disposed of. The new rules are effective for the Company on June 1, 2002. The Company is currently evaluating the impact of the adoption of SFAS No. 144, which the Company expects will not be material.

NOTE B - INVENTORIES

Inventories consist of the following:

	May 31,	
	2002	2001
Raw materials	$2,661,303	$3,364,276
Work in process	547,818	497,667
Finished goods	1,693,000	506,000
	$4,902,121	$4,367,943

NOTE C - FINANCING RECEIVABLES

In fiscal 2002, the Company entered into sales-type lease agreements for certain EECP units with two customers. The following table shows the future minimum rentals receivable under sales-type leases and future minimum lease payments and obligations under capital leases in effect for the twelve months ended May 31:

2003	$ 960,990
2004	859,560
2005	1,683,329
2006	628,680
2007	774,086
Thereafter	1,121,850
Total minimum lease payments	6,028,495
Less estimated executory costs	(493,684)
Net minimum lease payments	5,534,811
Less interest	(1,240,559)
Present value of minimum lease payments	4,294,252
Less valuation allowance	(718,879)
Net financing receivables	3,575,373
Less current portion	(633,786)
Long-term portion	$2,941,587

The annual minimum lease payments are subject to adjustment based on usage of the leased units in accordance with the provisions of the lease agreements.

NOTE D - PROPERTY AND EQUIPMENT

Property and equipment is summarized as follows:

	May 31, 2002	2001
Land	$ 200,000	$ 200,000
Building and improvements	1,366,855	1,252,423
Office, laboratory and other equipment	794,801	617,875
EECP units under operating leases or under loan for clinical trials	2,174,000	1,176,500
Furniture and fixtures	148,164	124,764
Leasehold improvements	117,803	112,578
	4,801,623	3,484,140
Less accumulated depreciation and amortization	(1,549,593)	(878,103)
	$ 3,252,030	$2,606,037

NOTE E - NOTES RECEIVABLE

In March 2002, the Company provided a $500,000 unsecured loan to a customer engaged in establishing a national network of EECP centers. This financing was part of an aggregate $3.2 million credit facility, subject to certain conditions, executed by the customer with the Company and an unaffiliated lender in January 2002, under which the Company has no further financing obligation. The customer issued two notes to the Company of $250,000 each in connection with two EECP centers that bear interest at 18% per annum and mature in September 2005. Payments of principal and interest under these notes will commence in April 2003 in varying amounts determined by a formula based upon cash generated, as defined in the loan agreement. In connection with this financing, the customer issued to the Company a warrant to purchase 52,620 of its common shares at $2.20 per share expiring in January 2007. The warrant contains a repurchase option for a 30-day period beginning December 1, 2006 (assuming no earlier liquidity event has taken place, as defined) that allows the Company, at its option, to require the customer to redeem the warrant for $249,945. The warrant value is collateralized by a subordinated security interest in the customer's accounts receivable.

Under a multi-year sales contract, the Company sold to this customer equipment (EECP units) under sales-type leases aggregating revenues of $3,160,792 in fiscal 2002. At May 31, 2002, financing receivables of approximately $2,563,000 from these sales-type lease transactions with this customer are outstanding (Note C). In fulfilling the requirements of the multi-year sales contract, the Company's concentration of credit risk with this customer may increase significantly.

NOTE F – LONG-TERM DEBT AND LINE OF CREDIT AGREEMENT

	May 31, 2002	2001
Revolving credit agreement (a)	$1,000,000	–
Term loans (b)	1,119,161	$1,141,667
	2,119,161	1,141,667
Less current portion	(1,046,445)	(33,074)
	$1,072,716	$1,108,593

(a) In February 2002, the Company renegotiated a secured revolving credit line with its existing bank. The credit line provides for borrowings up to $15,000,000, based upon eligible accounts receivable, as defined therein, at the Libor Rate plus 150 basis points (3.4% at May 31, 2002). At May 31, 2002, approximately $3,600,000 of the line was available of which there were outstanding borrowings of $1,000,000. Under the terms of the agreement, which expires in February 2005, the Company is required to meet certain covenants, including, among others, maintenance of minimum tangible net worth. In addition, the line is secured by substantially all the tangible assets of the Company.

(b) In November 2000, the Company purchased its headquarters and warehouse facility and secured two notes payable from a financial institution for $641,667 and $500,000, respectively, which bore interest at the Libor Rate plus 150 basis points and were payable in monthly installments of interest payments only. Concurrent with the building purchase, the Company had received long-term financing commitments under two programs sponsored by New York State. In September 2001, the Company refinanced $641,667 of the notes under the first New York State sponsored program at a fixed interest rate of 7.8% over a fifteen-year term. In January 2002, the second note for $500,000 was refinanced under the other program with a fixed interest rate of 6% over a fifteen-year term. These notes are payable in monthly installments consisting of principal and interest payments and are secured by the building.

Maturities of long-term debt are as follows at May 31, 2002:

2003	$ 46,445
2004	49,784
2005	53,367
2006	57,212
2007	61,339
Thereafter	851,014
	$1,119,161

NOTE G - STOCKHOLDERS' EQUITY AND WARRANTS

In fiscal 2000, all 175,000 shares outstanding of the 5% Series C Cumulative Convertible Preferred Stock issued in April 1998 were converted into 3,095,612 shares of common stock. In addition, warrants to purchase 1,435,000 shares of common stock were exercised (net of 101,910 shares offered in payment in lieu of cash), aggregating $1,272,000 in proceeds to the Company.

In fiscal 2001, warrants to purchase 776,212 shares of common stock were exercised, aggregating $1,143,000 in proceeds to the Company.

In fiscal 2002, warrants to purchase 15,000 shares of common stock were exercised, aggregating $31,200 in proceeds to the Company. Subsequent to May 31, 2002, warrants to purchase 250,000 shares of common stock were exercised, aggregating $112,500 in proceeds to the Company.

Warrants expire at varying dates between April 2003 and October 2006. Warrant activity for the years ended May 31, 2000, 2001 and 2002 is summarized as follows:

	Non-employee Directors	Employees	Consultants	Total	Price Range
Balance at June 1, 1999	400,000	1,275,000	1,378,712	3,053,712	$.38 - $2.18
Exercised	(400,000)	(525,000)	(510,000)	(1,435,000)	$.38 - $2.18
Balance at May 31, 2000	–	750,000	868,712	1,618,712	$.45 - $2.08
Exercised	–	(250,000)	(526,212)	(776,212)	$.45 - $2.08
Balance at May 31, 2001	–	500,000	342,500	842,500	$.45 - $2.08
Exercised			(15,000)	(15,000)	$2.08
Balance at May 31, 2002	–	500,000	327,500	827,500	$.45 - $2.08
Number of shares exercisable	–	500,000	327,500	827,500	$.45 - $2.08

The following table summarizes information about warrants outstanding and exercisable at May 31, 2002:

	Warrants Outstanding and Exercisable		
Range of Exercise Prices	Number Outstanding and Exercisable at May 31, 2002	Weighted Average Remaining Contractual Life (yrs.)	Weighted Average Exercise Price
$ .45	500,000	1.1	$ .45
$ .91	200,000	4.4	$ .91
$2.08	127,500	0.9	$2.08
	827,500	1.9	$ .81

NOTE H - OPTION PLANS

1995 Stock Option Plan

In May 1995, the Company's stockholders approved the 1995 Stock Option Plan for officers and employees of the Company, for which the Company reserved an aggregate of 1,500,000 shares of common stock. In December 1997, the Company's Board of Directors terminated the 1995 Stock Option Plan.

Outside Director Stock Option Plan

In May 1995, the Company's stockholders approved an Outside Director Stock Option Plan for non-employee directors of the Company, for which the Company reserved an aggregate of 300,000 shares of common stock. In December 1997, the Company's Board of Directors terminated the Outside Director Stock Option Plan.

1997 Stock Option Plan

In December 1997, the Company's stockholders approved the 1997 Stock Option Plan (the "1997 Plan") for officers, directors, employees and consultants of the Company, for which the Company has reserved an aggregate of 1,800,000 shares of common stock. The 1997 Plan provides that it will be administered by a committee of the Board of Directors of the Company and that the committee will have full authority to determine the identity of the recipients of the options and the number of shares subject to each option. Options granted under the 1997 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 principal stockholder who owns stock 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 committee but in no event shall exceed ten 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. The term for which options may be granted under the 1997 Plan expires August 6, 2007.

In January 1999, the Company's Board of Directors increased the number of shares authorized for issuance under the 1997 Plan by 1,000,000 shares to 2,800,000 shares. In addition, the Board of Directors granted stock options under the 1997 Plan to a consultant to purchase 150,000 shares of common stock at an exercise price of $.875 per share (which represented the fair market value of the underlying common stock at the time of grant). The stock options granted to the consultant were contingent upon meeting certain performance criteria. The stock options were fair-valued at $87,000 for which the Company recorded a charge to operations in fiscal 2000, commensurate with the satisfaction of the performance criteria defined therein.

1999 Stock Option Plan

In July 1999, the Company's Board of Directors approved the 1999 Stock Option Plan (the "1999 Plan"), for which the Company reserved an aggregate of 2,000,000 shares of common stock. The 1999 Plan provides that it will be administered by a committee of the Board of Directors of the Company and that the committee will have full authority to determine the identity of the recipients of the options and the number of shares subject to each option. Options granted under the 1999 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 principal stockholder who owns stock 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 committee but in no event shall exceed ten 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. The term for which options may be granted under the 1999 Plan expires July 12, 2009. In July 2000, the Company's Board of Directors increased the number of shares authorized for issuance under the 1999 Plan by 1,000,000 shares to 3,000,000 shares. In December 2001, the Board of Directors of the Company increased the number of shares authorized for issuance under the 1999 Plan by 2,000,000 shares to 5,000,000 shares.

In January 2001, the Board of Directors granted stock options under the 1999 Plan to a consultant to purchase 25,000 shares of common stock at an exercise price of $3.81 per share (which represented the fair market value of the underlying common stock at the time of the respective grant). The Company charged $60,000 to operations over the one-year period in which services were rendered. In December 2001, the Board of Directors granted stock options under the 1999 Plan to a consultant to purchase 25,000 shares of common stock at an exercise price of $2.95 per share (which represented the fair market value of the underlying common stock at the time of the respective grant). These stock options were fair-valued at $50,250 which the Company will charge to operations over the one-year period in which services are rendered. During fiscal 2002 and 2001, the Company charged $50,126 and $35,000, respectively, to operations for these grants.

In fiscal 2002, the Board of Directors granted stock options under the 1999 Plan to directors and employees to purchase an aggregate of 1,059,100 shares of common stock, at exercise prices ranging from $1.78 to $4.02 per share (which represented the fair market value of the underlying common stock at the time of the respective grants).

Activity under all the plans for the years ended May 31, 2000, 2001 and 2002 is summarized as follows:

		Outstanding Options		
	Shares Available for Grant	Number of Shares	Exercise Price per Share	Weighted Average Exercise Price
Balance at June 1, 1999	40,500	3,855,143	$ .75 - $3.44	$1.70
Shares authorized	2,000,000			
Options granted	(1,270,000)	1,270,000	$1.22 - $5.15	$1.95
Options exercised	–	(836,741)	$ .75 - $3.44	$1.85
Options canceled	134,668	(144,668)	$ .88 - $1.91	$1.47
Balance at May 31, 2000	905,168	4,143,734	$ .75 - $5.15	$1.76
Shares authorized	1,000,000			
Options granted	(798,000)	798,000	$2.66 - $5.00	$4.00
Options exercised	–	(497,911)	$ .75 - $3.44	$ .97
Options canceled	111,000	(111,000)	$ .75 - $3.47	$1.90
Balance at May 31, 2001	1,218,168	4,332,823	$ .78 - $5.15	$2.26
Shares authorized	2,000,000			
Options granted	(1,084,100)	1,084,100	$1.78 - $4.02	$3.61
Options exercised	–	(98,667)	$ .88 - $2.44	$1.71
Options canceled	125,333	(125,333)	$ .88 - $5.00	$3.90
Balance at May 31, 2002	**2,259,401**	**5,192,923**	**$ .78 - $5.15**	**$2.51**

The following table summarizes information about stock options outstanding and exercisable at May 31, 2002:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at May 31, 2002	Weighted Average Remaining Contractual Life (yrs.)	Weighted Average Exercise Price	Number Exercisable at May 31, 2002	Weighted Average Exercise Price
$ .75 - $ .88	979,779	4.6	$ .87	980,779	$ .87
$1.22 - $1.78	968,250	7.5	$1.37	484,918	$1.41
$1.91 - $2.78	842,727	6.1	$2.01	762,461	$1.94
$2.89 - $4.28	2,144,667	7.6	$3.69	836,000	$3.60
$4.59 - $5.15	257,500	7.7	$4.82	132,500	$4.92
	5,192,923	6.8	$2.51	3,196,658	$2.09

As permitted under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), the Company has elected to follow APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") in accounting for stock-based awards. Pursuant to APB 25, the Company generally recognizes no compensation expense with respect to such awards. Pro forma information regarding net income and earnings per share is required for awards granted as if the Company had accounted for its stock-based awards under the fair value method of SFAS No. 123. The fair value of the Company's stock-based awards was estimated using the Black-Scholes option valuation model. The fair value of the Company's stock-based awards was estimated assuming no expected dividends and the following weighted-average assumptions:

	Fiscal year ended May 31,		
	2002	2001	2000
Expected life (years)	5	5	5
Expected volatility	86%	80%	80%
Risk-free interest rate	3.9%	5.2%	6.0%

The following are the pro forma net earnings and net earnings per share – basic and diluted amounts for fiscal 2002, 2001 and 2000, as if compensation expense for stock-based awards had been determined based on their estimated fair value at the date of grant:

	2002	2001	2000
Pro forma net earnings	$ 1,642,986	$10,382,690	$576,435
Pro forma net earnings per share - basic	$ .03	$ .18	$ .01
- diluted	$ .03	$ .17	$ .01

The weighted-average fair value of options granted during fiscal 2002, 2001 and 2000 was $2.50, $2.73 and $2.75, respectively. At May 31, 2002, there were approximately 11,617,000 remaining authorized shares of common stock after reserves for all stock option plans, stock warrants and shareholders' rights.

NOTE 1 – EARNINGS PER COMMON SHARE

Basic earnings per share are based on the weighted average number of common shares outstanding without consideration of potential common stock. Diluted earnings per share are based on the weighted number of common and potential common shares outstanding. The calculation takes into account the shares that may be issued upon the exercise of stock options and warrants, reduced by the shares that may be repurchased with the funds received from the exercise, based on the average price during the period. Options and warrants to purchase 2,432,000 and 893,000 shares of common stock were excluded from the computation of diluted earnings per share as of May 31, 2002 and 2001, respectively, because the effect of their inclusion would be antidilutive.

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

	For the fiscal year ended May 31,		
	2002	2001	2000
Numerator:			
Basic earnings	$ 2,786,106	$11,694,350	$ 1,690,916
Preferred stock dividends	–	–	(94,122)
Diluted earnings	$ 2,786,106	$11,694,350	$ 1,596,794
Denominator:			
Basic – weighted average shares	57,251,035	56,571,402	52,580,623
Stock options	1,624,744	2,270,094	1,389,607
Warrants	592,313	1,085,703	1,428,678
Convertible preferred stock	–	–	1,743,041
Diluted – weighted average shares	59,468,092	59,927,199	57,141,949
Earnings per share - basic	$ .05	$ .21	$ .03
- diluted	$ .05	$ .20	$ .03

NOTE J - INCOME TAXES

In fiscal 2002, the Company recorded an expense for income taxes of $1,554,000, inclusive of $39,000 in current tax expense and a deferred tax expense of $1,515,000. In fiscal 2001, the Company recorded a benefit for income taxes of $6,457,108, inclusive of $139,892 in current tax expense principally resulting from the federal alternative minimum tax and a deferred tax benefit of $6,597,000 resulting principally from the change in the valuation allowance. In fiscal 2000, the Company recorded a $400,000 benefit for income taxes resulting principally from a change in the deferred tax valuation allowance.

The Company's deferred tax assets are summarized as follows:

	May 31,		
	2002	2001	2000
Deferred tax assets			
Net operating loss and other carryforwards	$11,344,000	$13,422,000	$14,627,000
Accrued compensation	–	–	12,500
Bad debts	493,000	178,000	187,000
Other	854,000	606,000	238,500
Total gross deferred tax assets	12,691,000	14,206,000	15,065,000
Valuation allowance	–	–	(14,665,000)
Net deferred tax assets	$12,691,000	$14,206,000	$ 400,000

The fiscal 2002 tax expense does not include the tax benefit associated with the current exercises of stock options and warrants, aggregating $58,000, which was credited directly to additional paid-in capital in the current year.

The fiscal 2001 deferred tax benefit does not include the tax benefit associated with the current and prior years' exercises of stock options and warrants, aggregating $7,209,000, which was credited directly to additional paid-in capital in such year.

In fiscal 2000, management had established a valuation allowance for a significant portion of the deferred tax assets based on uncertainties with respect to the Company's ability to generate future taxable income. At May 31, 2000, the valuation allowance primarily related to net operating losses and a $6,165,000 tax benefit from the exercise of stock options and warrants included in the net operating loss carryforward.

As of May 31, 2001, management determined that no valuation allowance was required based upon its financial performance, which was positively affected by the availability of Medicare coverage and reimbursement and the increasing acceptance by the medical community of the Company's cost-effective and noninvasive therapy system. In addition, the Company's assessment of the cardiovascular disease marketplace, which includes favorable patient demographics and unmet clinical needs, provides a substantial economic opportunity and anticipated future earnings stream with respect to current and prospective clinical applications for its products. Ultimate realization of the deferred tax assets is dependent upon the Company generating sufficient taxable income prior to the expiration of the loss carryforwards. Although realization is not assured, management believes it is more likely than not that the net deferred tax assets will be realized. The amount of the deferred tax assets considered realizable, however, could be reduced in the future if estimates of future taxable income during the carryforward period are reduced.

At May 31, 2002, the Company had net operating loss carryforwards for Federal income tax purposes of approximately $33,366,000, expiring at various dates from 2005 through 2020.

The following is a reconciliation of the effective income tax rate to the federal statutory rate:

	2002		2001		2000	
	Amount	%	Amount	%	Amount	%
Federal statutory rate	$ 1,475,000	34.0	$1,781,000	34.0	$ 387,911	34.0
State taxes, net	56,000	1.3	65,000	1.2	83,451	7.3
Permanent differences	23,000	.5	67,300	1.3	89,756	7.8
Utilization of net operating loss	–	–	(1,781,000)	(34.0)	(561,118)	(49.1)
Change in valuation allowance relating to operations	–	–	(6,719,000)	(128.3)	(400,000)	(35.0)
Other	–	–	129,592	2.5	–	–
	$1,554,000	35.8	$(6,457,108)	(123.3)	$(400,000)	(35.0)

Under current tax law, the utilization of tax attributes will be restricted if an ownership change, as defined, were to occur. Section 382 of the Internal Revenue Code provides, in general, that if an "ownership change" occurs with respect to a corporation with net operating and other loss carryforwards, such carryforwards will be available to offset taxable income in each taxable year after the ownership change only up to the "Section 382 Limitation" for each year (generally, the product of the fair market value of the corporation's stock at the time of the ownership change, with certain adjustments, and a specified long-term tax-exempt bond rate at such time). The Company's ability to use its loss carryforwards would be limited in the event of an ownership change.

NOTE K - COMMITMENTS AND CONTINGENCIES

Employment Agreements

The Company maintains employment agreements with certain executive officers, expiring at various dates through January 2005. One of the employment agreements contains a provision that provides for automatic one-year extensions through November 2005 provided no non-renewal notice is given. All such employment agreements provide, among other things, that in the event there is a change in the control of the Company, as defined therein, or in any person directly or indirectly controlling the Company, as also defined therein, the employee has the option, exercisable within six months of becoming aware of such event, to terminate the employment agreement. Upon such termination, the employee has the right to receive, as a lump-sum payment, certain compensation remaining to be paid for the balance of the term of the agreement.

The approximate aggregate minimum compensation obligation under active employment agreements at May 31, 2002 are summarized as follows:

Fiscal Year	Amount
2003	$270,000
2004	150,000
2005	100,000
	$520,000

Leases

The Company leases additional warehouse space under three non-cancelable operating leases, two of which expire on October 31, 2002 and one on September 30, 2006. Rent expense was $85,000, $69,000 and $130,000 in fiscal 2002, 2001 and 2000, respectively.

Approximate aggregate minimum annual obligations under these lease agreements and other equipment leasing agreements at May 31, 2002 are summarized as follows:

Fiscal Year	Amount
2003	$87,000
2004	48,000
2005	42,000
2006	37,000
2007	12,000
	$226,000

Litigation

In February 1999, an action was commenced in the Massachusetts Superior Court, Essex County, against the Company. The action sought damages in the sum of $1,000,000 based upon an alleged breach of a sales contract. In January 2002, this matter was dismissed by the court.

In June 2001, an action was commenced in the New York Supreme Court, Nassau County, against the Company by the former holder of a warrant to purchase 100,000 shares of the Company's stock seeking undefined damages based upon a claim that the Company breached an agreement to register the common shares underlying the warrant at the "earliest practicable date" after due demand by the warrant holder had been made. The Company believes that it fulfilled its obligations under the warrant to the plaintiff in a timely fashion and that the complaint is without merit. Accordingly, the Company is defending the action vigorously. Although discovery has been completed, the Company is yet unable to establish the likelihood of an unfavorable outcome or the existence or amount of any potential loss.

In or about late June 2002, the Company was notified by a letter from the domestic counsel for Foshan Life Sciences Co. Ltd. ("FLSC"), a joint venture comprised of a Florida company and Vamed Medical Instrument Company Limited ("Vamed"), a Chinese company with whom the Company had an agreement to manufacture the Company's EECP Model MC2 system, that FLSC was initiating an arbitration proceeding before the Hong Kong International Arbitration Council ("HKIAC") to recover compensatory and punitive damages in excess of $1,000,000 and injunctive relief based upon claims of breach of the manufacturing agreement, tortious interference and misappropriation of confidential information and trade secrets. Although possessing several substantive defenses to these claims, the Company initially has challenged the HKIAC's right to hear and determine the dispute on the ground that FLSC is neither a legitimate nor recognized party to the manufacturing agreement which provides for such arbitration and, therefore, is not entitled to enforce the same. The Company also has demanded that FLSC deposit with the HKIAC security to cover the Company's costs of arbitration. To date, FLSC has neither responded to the Company's demand for security nor apparently filed a formal statement of claim with the HKIAC.

401(k) Plan

In April 1997, the Company adopted the Vasomedical, Inc. 401(k) Plan to provide retirement benefits for its employees. As allowed under Section 401(k) of the Internal Revenue Code, the plan provides tax-deferred salary deductions for eligible employees. Employees are eligible to participate in the next quarter enrollment period after employment. Participants may make voluntary contributions to the plan up to 15% of their compensation. In fiscal 2002, the Company made contributions of approximately $20,000 to match a percentage of employee contributions. No Company contributions were made for the fiscal years ended May 31, 2001 and 2000.

Purchase Commitments

At May 31, 2002, the Company had outstanding purchase commitments of $324,000 with Foshan Life Sciences Co. Ltd. ("FLSC"), a Chinese company that has assumed the operational activities of Vamed, another Chinese company, for the manufacture of its EECP Model MC2 system. The Company believes that FLSC will be able to meet the Company's future need for this system.

NOTE L – SUMMARY OF QUARTERLY FINANCIAL DATA *(Unaudited)*

The following is a summary of the Company's unaudited quarterly operating results for the years ended May 31, 2002 and 2001.

	Three months ended (in 000s except earnings per share data)							
	May 31, 2002	Feb. 28, 2002	Nov. 30, 2001	Aug. 31, 2001	May 31, 2001	Feb. 28, 2001	Nov. 30, 2000	Aug. 31, 2000
Revenues	$8,641	$8,019	$8,544	$9,626	$8,741	$7,068	$6,454	$5,245
Gross Profit	$6,083	$5,382	$5,980	$6,847	$6,115	$4,836	$4,765	$3,882
Net Earnings	$ 440	$ 98	$1,005	$1,243	$6,814	$1,785	$1,695	$1,400
Earnings per share								
- basic	$ .01	$ .00	$ .02	$ .02	$ .12	$ .03	$ .03	$ .02
- diluted	$ .01	$ .00	$ .02	$ .02	$ .11	$ .03	$ .03	$ .02
Weighted average common shares outstanding								
- basic	57,309	57,281	57,207	57,198	57,068	56,711	56,383	56,129
- diluted	59,256	59,469	59,364	59,776	60,299	59,891	59,852	59,694

Report of Independent Certified Public Accountants

Stockholders and Board of Directors of Vasomedical, Inc.

We have audited the accompanying consolidated balance sheets of Vasomedical, Inc. and Subsidiaries (the "Company") as of May 31, 2002 and 2001, and the related consolidated statements of earnings, changes in stockholders' equity and cash flows for each of the three fiscal years in the period ended May 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of May 31, 2002 and 2001, and the consolidated results of their operations and their consolidated cash flows for each of the three fiscal years in the period ended May 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

GRANT THORNTON LLP

Melville, New York
July 26, 2002

Market for the Company's Common Stock and Related Security Holder Matters

The Company's Common Stock trades on the Nasdaq SmallCap Market tier of The Nasdaq Stock Market℠ under the symbol VASO. The approximate number of record holders of Common Stock as of August 6, 2002 was 1,000, which does not include approximately 34,250 beneficial owners of shares held in the name of brokers or other nominees. The table below sets forth the range of high and low trade prices of the Common Stock as reported by the Nasdaq SmallCap Market tier of The Nasdaq Stock Market℠ for the fiscal periods specified.

	Fiscal 2002		Fiscal 2001	
	High	Low	High	Low
First Quarter	$4.32	$3.51	$5.50	$3.56
Second Quarter	$3.75	$2.26	$5.50	$2.53
Third Quarter	$4.02	$2.65	$5.63	$2.00
Fourth Quarter	$3.30	$1.65	$5.00	$2.94

The last bid price of the Company's Common Stock on August 12, 2002 was $2.19 per share. The Company has never paid any cash dividends on its Common Stock. While the Company does not intend to pay cash dividends in the foreseeable future, payment of cash dividends, if any, will be dependent upon the earnings and financial position of the Company, investment opportunities and such other factors as the Board of Directors deems pertinent. Stock dividends, if any, also will be dependent on such factors as the Board of Directors deems pertinent.

Corporate Directory

Senior Management

Photios T. Paulson
Chief Executive Officer

Gregory D. Cash
President and Chief Operating Officer

John C. K. Hui, PhD
Senior Vice President and Chief Technology Officer

Joseph A. Giacalone
Chief Financial Officer and Secretary

Harold Kaefer
Vice President, Engineering and Manufacturing

CJ McGroarty IV
Vice President, Sales

Thomas R. Varricchione
Vice President, Clinical and Regulatory Affairs

Board of Directors

Abraham E. Cohen
Chairman, Vasomedical Inc.
Former President of Merck International and Senior Vice President of Merck and Co., Inc.

Alexander G. Bearn, MD
Former Executive Officer of the American Philosophical Society
Adjunct Professor, Rockefeller University
Former Chairman of the Department of Medicine of Cornell University Medical College and Senior Vice President of Medical and Scientific Affairs of Merck International

David S. Blumenthal, MD
Practicing Cardiologist affiliated with Weill-Cornell Medical College

John C. K. Hui, PhD
Senior Vice President and Chief Technology Officer, Vasomedical Inc.

Photios T. Paulson
Chief Executive Officer, Vasomedical Inc.
Former Chairman, bioMerieux N.A.

Kenneth W. Rind, PhD
Chairman, Oxford Venture Corporation
Founding General Partner of Israel Infinity Venture Capital Fund
Former Vice President of Corporate Finance, Oppenheimer & Co., Inc.

E. Donald Shapiro
Dean Emeritus, Former Dean, New York Law School

Anthony Viscusi
President and CEO, Vasomedical Inc. (Retired)

Forrest R. Whittaker
President, Respiratory Division, Tyco Healthcare Inc.
Former President and CEO, Paidos Health Management Services, Inc.

Martin Zeiger
Senior Vice President, Strategic Business Development, Barr Laboratories, Inc.
Former General Counsel, Barr Laboratories, Inc.

Executive Committee of the Scientific Council

Chairman

Anthony N. DeMaria, MD, MACC
Judith and Jack White Chair in Cardiology
Professor of Medicine
Chief, Cardiovascular Medicine
University of California, San Diego

Members

George A. Beller, MD, MACC
Chief, Cardiovascular Division
Professor of Medicine
University of Virginia

C. Richard Conti, MD, MACC
Professor of Medicine
Director, Cardiovascular Clinic
University of Florida
Eminent Scholar (Cardiology)

Arthur M. Feldman, MD, PhD, FACC
McGee Professor and Chairman, Department of Medicine
Thomas Jefferson Medical College

David R. Holmes Jr., MD, FACC
Consultant, Cardiovascular Disease Division
Director, Cardiac Catheterization Laboratory
Professor of Medicine
Mayo Clinic and Foundation
St. Mary's Hospital

General Counsel

Blau, Kramer, Wactlar & Lieberman, P.C.
Attorneys at Law
100 Jericho Quadrangle
Jericho, New York 11753

Auditors

Grant Thornton LLP
Certified Public Accountants
Suite 3S01
One Huntington Quadrangle
Melville, New York 11747

Registrar and Transfer Agent

American Stock Transfer and Trust Company
59 Maiden Lane
New York, New York 10038
800-937-5449

Other Available Information

A copy of the Company's Annual Report on Form 10-K for the year ended May 31, 2002, as filed with the Securities and Exchange Commission, is available without charge to interested stockholders upon a written request to:

Vasomedical Inc.
Attn.: Investor Relations
180 Linden Avenue
Westbury, New York 11590

Or visit our website at www.vasomedical.com

Z-1 (1102)

Design: RWI (www.rwidesign.com)