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MEDSTONE INTERNATIONAL INC/  
Form 10-Q  
May 14, 2001

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2001

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-16752

MEDSTONE INTERNATIONAL, INC.

-----  
(Exact name of registrant as specified in its charter)

DELAWARE

66-0439440

-----  
(State or other jurisdiction of  
incorporation or organization)

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

100 Columbia, Suite 100, Aliso Viejo, California

92656

-----  
(Address of principal executive offices)

(Zip code)

Registrant's telephone number, including area code: (949) 448-7700

-----  
Not Applicable

(Former name, former address and former fiscal year, if changed,  
since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes  No   
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The number of shares of the Common Stock of the registrant outstanding as of May 4, 2001 was 4,198,220.

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MEDSTONE INTERNATIONAL, INC.

INDEX TO FORM 10-Q

PART I. FINANCIAL INFORMATION

	Page No.
	-----
Item 1. Financial Statements:	
Consolidated Balance Sheets	
March 31, 2001 (Unaudited) and	
December 31, 2000	3
Consolidated Statements of Income	
Three Months Ended March 31, 2001 and 2000 (Unaudited)	4
Consolidated Statement of Stockholders' Equity	
Three Months Ended March 31, 2001 (Unaudited)	5
Consolidated Statements of Cash Flows	
Three Months Ended March 31, 2001 and 2000 (Unaudited)	6
Notes to Unaudited Consolidated Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition	
and Results of Operations	11

PART II. OTHER INFORMATION

Item 1. Legal Proceedings	15
Item 2. Changes in Securities	15
Item 3. Defaults Upon Senior Securities	15
Item 4. Submission of Matters to a Vote of Security Holders	15
Item 5. Other Information	15
Item 6. Exhibits and Reports on Form 8-K	15
Signatures	16

-2-

MEDSTONE INTERNATIONAL, INC.  
CONSOLIDATED BALANCE SHEETS

March 31,	December 31,
2001	2000
-----	-----
(Unaudited)	

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ASSETS

Current assets:		
Cash and cash equivalents	\$ 2,041,671	\$ 945,610
Short-term investments held to maturity	4,405,917	5,223,659
Accounts receivable, less allowance for doubtful accounts of \$507,181 at March 31, 2001 and \$477,180 at December 31, 2000, respectively	4,195,059	4,165,563
Inventories, less allowance for inventory obsolescence of \$414,417 at March 31, 2001 and \$457,088 at December 31, 2000, respectively	6,181,633	6,103,051
Deferred tax assets	1,005,814	1,005,814
Prepaid expenses and other current assets	372,627	526,825
	-----	-----
Total current assets	18,202,721	17,970,522
Buildings, property and equipment, at cost:		
Building	359,324	359,324
Lithotripters	12,831,112	12,316,739
Equipment, furniture and fixtures	2,911,857	2,784,217
Leasehold improvements	157,083	157,083
	-----	-----
	16,259,376	15,617,363
Less accumulated depreciation and amortization	(10,963,341)	(10,440,172)
	-----	-----
Net property and equipment	5,296,035	5,177,191
	-----	-----
Goodwill, net	3,282,410	3,306,622
Investment in unconsolidated subsidiaries	1,293,107	1,263,598
Long-term receivable from unconsolidated subsidiary	2,000,000	2,000,000
Other assets, net	135,464	158,914
	-----	-----
	\$ 30,209,737	\$ 29,876,847
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	\$ 848,078	\$ 657,878
Accrued expenses	559,596	580,232
Accrued income taxes	245,004	73,314
Accrued payroll expenses	293,063	347,034
Customer deposits	343,708	58,441
Deferred revenue	598,339	656,332
	-----	-----
Total current liabilities	2,887,788	2,373,231
Deferred tax liabilities	562,313	562,313
Minority interest	529,687	554,292
Deferred rent	81,402	78,697
Stockholders' equity:		
Common stock - \$.004 par value, 20,000,000 shares authorized, 5,742,670 shares issued and outstanding at both March 31, 2001 and December 31, 2000, respectively	22,971	22,971
Additional paid-in capital	19,646,388	19,646,388
Accumulated earnings	17,058,936	16,708,143
Accumulated other comprehensive income	50,872	55,395
Treasury stock, at cost, 1,519,450 and 1,434,450 shares at March 31, 2001 and December 31, 2000, respectively	(10,630,620)	(10,124,583)
	-----	-----
Total stockholders' equity	26,148,547	26,308,314
	-----	-----
	\$ 30,209,737	\$ 29,876,847

See accompanying notes

-3-

## MEDSTONE INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF INCOME  
 Three months ended March 31, 2001 and 2000  
 (Unaudited)

	2001	2000
	-----	-----
Revenues:		
Procedures, maintenance fees and fee-for-service...	\$4,510,773	\$4,650,318
Net equipment sales.....	353,181	1,329,044
Interest income.....	141,886	129,997
	-----	-----
Total revenues.....	5,005,840	6,109,359
Costs and operating expenses:		
Cost of equipment sales.....	350,288	926,414
Cost of procedures and maintenance fees.....	2,833,030	2,695,744
Research and development.....	260,957	257,053
Selling.....	530,622	534,670
General and administrative.....	664,029	724,189
	-----	-----
Total costs and operating expenses.....	4,638,926	5,138,070
	-----	-----
Operating income.....	366,914	971,289
Other expense (income):		
Gain on sale of investments.....	(358,108)	(782,557)
Other expense.....	33,343	10,111
	-----	-----
Total other expenses (income).....	(324,765)	(772,446)
	-----	-----
Minority interests:		
Minority interest in subsidiaries income.....	155,395	191,459
Equity in income from unconsolidated subsidiary....	(29,509)	---
	-----	-----
Total minority interest.....	125,886	191,459
	-----	-----
Income before provision for income taxes.....	565,793	1,552,276
Provision for income taxes.....	215,000	630,000
	-----	-----
Net income.....	\$ 350,793	\$ 922,276
	=====	=====
Net income per share:		
Basic.....	\$ .08	\$ .20
	=====	=====
Diluted.....	\$ .08	\$ .20
	=====	=====
Number of shares used in the computation of earnings per share:		
Basic.....	4,273,220	4,622,692
	=====	=====

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Diluted.....	4,281,932	4,649,818
	=====	=====

See accompanying notes.

-4-

MEDSTONE INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock			Additional Accumulated earnings	Accumul Comprehe income (
	Number of shares	Amount	paid-in capital		
Balance at December 31, 2000	4,308,220	\$22,971	\$19,646,388	\$16,708,143	\$55,
	=====	=====	=====	=====	=====
Net income	---	---	---	350,793	
Other comprehensive income: Unrealized loss on foreign currency translation, net	---	---	---	---	(4,
Total comprehensive income					
Treasury stock repurchased	(85,000)	---	---	---	
	-----	-----	-----	-----	-----
Balance at March 31, 2001 (Unaudited)	4,223,220	\$22,971	\$19,646,388	\$17,058,936	\$50,
	=====	=====	=====	=====	=====

See accompanying notes.

-5-

MEDSTONE INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Three months ended March 31, 2001 and 2000  
(Unaudited)

2001

2000

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	-----	-----
Cash flows from operating activities:		
Net income.....	\$ 350,793	\$ 922,276
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization.....	554,900	595,872
Provision for doubtful accounts.....	30,000	---
Provision for inventory obsolescence.....	42,000	10,000
Gain on sale of long-term investments.....	(358,108)	(782,557)
Minority interest in partnerships.....	155,395	191,459
Minority equity in unconsolidated subsidiary...	(29,509)	---
Changes in assets and liabilities:		
Accounts receivable.....	(59,496)	(692,324)
Inventories.....	(120,582)	48,490
Prepaid expenses and other current assets.....	154,198	(60,235)
Accounts payable and accrued expenses.....	176,290	(91,351)
Accrued payroll expenses.....	(53,971)	130,333
Accrued income taxes.....	168,674	534,586
Deferred revenue.....	(57,993)	36,148
Customer deposits.....	285,267	6,000
Other, net.....	18,602	37,113
	-----	-----
Net cash provided by operating activities.....	1,256,460	885,810
	-----	-----
Cash flows from investing activities:		
Purchase of short-term investments.....	(3,333,231)	(2,479,122)
Proceeds from sales of short-term investments...	4,150,973	5,557,862
Proceeds from sale of long-term investments.....	358,108	782,557
Distribution of minority interest.....	(180,000)	(112,000)
Purchase of property and equipment, net.....	(646,191)	(402,628)
	-----	-----
Net cash provided by investing activities.....	349,659	3,346,669
	-----	-----
Cash flows from financing activities:		
Purchase of treasury stock.....	(506,037)	(391,675)
Deferral of rent payments.....	2,705	---
Loan payments.....	(6,726)	(6,783)
	-----	-----
Net cash used in financing activities.....	(510,058)	(398,458)
	-----	-----
Net increase in cash and cash equivalents.....	1,096,061	3,834,021
Cash and equivalents at beginning of period.....	945,610	1,061,422
	-----	-----
Cash and equivalents at end of period.....	\$ 2,041,671	\$ 4,895,443
	=====	=====
Supplemental cash flow disclosures:		
Cash paid during the period for:		
Income taxes.....	\$ 59,847	\$ 115,604
	=====	=====

See accompanying notes.

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MEDSTONE INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
March 31, 2001

1. Basis of presentation

The accompanying condensed consolidated financial statements include the accounts of Medstone International, Inc. and its subsidiaries (the Company). All significant intercompany transactions and accounts have been eliminated.

In the opinion of the Company's management, the accompanying unaudited condensed consolidated financial statements include all adjustments (which consist only of normal recurring adjustments) necessary for a fair presentation of its consolidated financial position at March 31, 2001 and consolidated results of operations and cash flows for the periods presented. Although the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information and disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These financial statements should be read in conjunction with the Company's audited financial statements included in the Company's 2000 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 30, 2001. Results of operations for the three months ended March 31, 2001 are not necessarily indicative of results to be expected for the full year.

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

2. Recently Issued Accounting Pronouncements

Effective January 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative and Hedging Activities," as amended.

SFAS 133 established a new model for accounting for derivatives and hedging activities. Under SFAS 133, all derivatives must be recognized as assets and liabilities and measured at fair value. The Company currently does not have any derivative instruments which require fair value measurement under SFAS 133 and, accordingly, the effect of the adoption will not have a material impact on the Company's consolidated financial position or results of operations.

-7-

3. Accumulated Other Comprehensive (Loss)/Income:

The components of accumulated other comprehensive (loss)/income are as follows:

	Currency Translation Adjustment -----
Balance at December 31, 2000	\$ 55,395

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Foreign currency translation adjustments	(4,523)
	-----
Balance at March 31, 2001	\$ 50,872
	=====

The functional currency of the investment in foreign subsidiary is considered to be the United States dollar.

The earnings associated with the Company's investment in its foreign subsidiary are considered to be permanently invested and no provision for U.S. federal and state income taxes on those earnings or translation adjustments has been provided.

For the three months ended March 31, 2001, total comprehensive income was \$346,270. For the three months ended March 31, 2000, total comprehensive income was \$982,469.

#### 4. Business Segments

The Company operates in two business segments, equipment sales and fees for procedures, maintenance and management.

	Three Months Ended	
	March 31, 2001	March 31, 2000
	-----	-----
Revenue:		
Equipment sales	\$ 353,181	\$1,329,044
Fees for procedures, maintenance fees and fee-for-service	4,510,773	4,650,318
	-----	-----
	\$4,863,954	\$5,979,362
	=====	=====
Operating income (loss):		
Equipment sales	\$ 9,366	\$ 109,181
Fees for procedures, maintenance fees and fee-for-service	357,548	862,108
	-----	-----
	\$ 366,914	\$ 971,289
	=====	=====

-8-

#### 5. Per share information

The Company has adopted SFAS No. 128 "Earnings Per Share," and applied this pronouncement to all periods presented. This statement requires the presentation of both basic and diluted net income per share for financial statement purposes. Basic net income per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding. Diluted net income per share includes the effect of the potential shares outstanding, including dilutive stock options and warrants using the treasury stock method.



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

	Three Months Ended	
	March 31, 2001	March 31, 2000
Numerator: Net income.....	\$ 350,793	\$ 922,276
	=====	=====
Denominator for weighted average shares outstanding.....	4,273,220	4,622,692
	=====	=====
Basic earnings per share.....	\$ .08	\$ .20
	=====	=====
Effect of dilutive securities:		
Weighted average shares outstanding.....	4,273,220	4,622,692
Stock options.....	8,712	27,126
	-----	-----
Denominator for diluted earnings per share.....	4,281,932	4,649,818
	=====	=====
Diluted earnings per share.....	\$ .08	\$ .20
	=====	=====

Common equivalent shares result from the assumed exercise of outstanding dilutive securities when applying the treasury stock method. Fully diluted per share information is not presented for periods in which the effect is antidilutive.

### F. Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and consist of the following:

	March 31, 2001	December 31, 2000
Raw materials	\$4,294,473	\$3,888,640
Work in process	182,732	231,175
Finished goods	1,704,428	1,983,236
	-----	-----
	\$6,181,633	\$6,103,051
	=====	=====

-9-

### G. Contingencies

From time to time, the Company is subject to legal actions and claims for personal injuries or property damage related to patients who use its products. The Company has obtained a liability insurance policy providing coverage for product liability and other claims. Management does not believe that the resolution of any current proceedings will have a material financial impact on the Company or the consolidated financial statements.

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### H. Stock Repurchase Plan

In the first quarter of 2001 the Company purchased a total of 85,000 shares at an aggregate cost of \$506,038 under the Company's current Stock Repurchase Plan. To date under all of the Company's stock repurchase plans a total of 1,519,450 shares have been repurchased at a total cost of \$10,630,620.

### I. Subsequent Events

On April 2, 2001, the Company repurchased a total of 25,000 shares of its common stock for a cost of approximately \$144,000, which completes its existing Stock Repurchase Program.

-10-

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

The following discussion and analysis should be read in conjunction with the Company's audited financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's 2000 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 30, 2001.

### Results of Consolidated Operations

-----

#### General

Medstone manufactures, markets and maintains lithotripters, and continues to expand its Fee-for-Service Program to supply lithotripsy equipment to providers on a per procedure basis. The lithotripters manufactured by Medstone is approved to treat both kidney stones and gallstones. The Company is also marketing a urology imaging and treatment table, used for various urological functions, mobile urology and pain management table to serve the mobile treatment market and various radiology room equipment, capitalizing on the relationships that the Company has with radiology equipment manufacturers. To date, the Company's consolidated revenues have come primarily from Medstone's lithotripsy business.

As a manufacturer of medical devices, the Company has been vertically integrating by offering its medical devices directly to providers. It currently offers lithotripsy procedures using 15 mobile systems, two fixed sites and 22 transmobile lithotripters located throughout the United States on a per procedure basis. With the ability to offer quality equipment at reasonable prices, Medstone intends to continue the growth of this manufacturer direct business.

### Three Months Ended March 31, 2001 Compared to Three Months Ended March 31, 2000

-----

The Company recorded total revenue of \$5.0 million in the first quarter of 2001, an 18% decrease compared to the first quarter of 2000. Equipment revenues decreased to \$353,181 in the quarter ending March 31, 2001 from \$1,329,044 in the comparable quarter of the prior year, or a 73% decrease, as the Company shipped 16 imaging tables in 2001 versus four lithotripsy systems and two Pro 2000T urology tables in 2000. Revenues from procedures, maintenance fees and fee-for-service decreased from \$4.7 million in the three months ended March 31, 2000 to \$4.5 million in the same period of the current year due to lower average per patient reimbursement and expiration of maintenance service contracts on

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third party-owned equipment.

Interest income increased by 9% in the first quarter of 2001 when compared to the same period of the prior year due to higher investment yields even though the average invested balance has decreased.

Cost of sales on equipment sales increased to 99% of sales in the three months ended March 31,

-11-

2001 compared to 70% of sales in the same period of 2000. This increase is due to a higher cost of sales of imaging table equipment and the corresponding manufacturing overhead costs for producing equipment. Recurring revenue cost of sales increased to 63% of sales in the quarter ended March 31, 2001 compared to 58% in the same quarter of the prior year due to the additional equipment in service to provide fee-for-service lithotripsy in the mobile and transmobile environments. Overall cost of sales, as a percentage of revenue (excluding interest), increased to 65% in the first quarter of 2001 compared to 61% in the first quarter of 2000.

Research and development costs increased by 2%, in the first quarter of 2001 when compared to the same quarter of 2000 as the Company incurred development costs for the UroPro-2000 urology imaging table in both periods.

Selling costs decreased to \$531,000 in the first quarter of 2001 compared to \$535,000 in the same period of the prior year due to higher tradeshow, advertising and travel expenses for the introduction of the UroPro 2000 and gallstone applications offset by lower commission costs on lower equipment shipments.

General and administrative expenses decreased by \$60,000 or 8% in the three months ended March 31, 2001 compared to the same period in the prior year. This is due to lower consulting expenses in the U.K. operations, lower audit fees due to the prior year's acquisition of Medicredit.com, Inc. and lower spending on the gallstone application.

Gain on sale of investments was approximately \$358,000 in the quarter ending March 31, 2001 compared to \$783,000 in the same period of 2000 as the Company's sold 73,000 shares of Cardiac Science, Inc. common stock, in the current year, whereas the Company sold 140,167 shares of Cardiac Science and 5,000 shares of Genstar Therapeutics Corp. in the same period of 2000. The net book value of all shares was \$0.

Minority interests decreased to \$126,000 in the three months ended March 31, 2001 compared to \$191,000 in the same period of the prior year due to lower profits in the Northern Nevada and Southern Idaho operations and recognition of equity income of \$29,000 from the Medicredit.com, Inc. operations in 2001.

Provision for income taxes for the first quarter of 2001 decreased by \$415,000 as a result of lower taxable income in the current year when compared to the same period of 2000.

Three Months Ended March 31, 2000 Compared to Three Months Ended March 31, 1999

---

The Company recognized revenues of approximately \$6.1 million in the first quarter of 2000, a 25% increase compared to \$4.9 million in the corresponding period of 1999. Equipment revenues increased in the first quarter of 2000 as four lithotripsy units were shipped in that period compared to no unit shipments in the first three months of 1999 as customers were waiting for the

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introduction of the Company's STS-T transportable lithotripsy product. The revenue from the Company's procedures,

-12-

maintenance fees and fee-for-service activities decreased by 2%, or \$117,000 in the first three months of 2000 when compared to the same period of 1999. The decrease is due to a 9% decrease in fee-for-service revenue in the first three months of 2000 when compared to the same period in the prior year due to conversions of several sites from fee-for-service to unit purchases. Offsetting most of the decrease in fee-for-service revenue is an increase in revenues from the new imaging product lines introduced in 1999 or added through acquisitions during 1999. Competitive pressures for fee-for-service continues to negatively impact revenue growth.

Cost of sales on equipment sales were 70% in the three months ended March 31, 2000. The current year's cost of sales as a percentage of sales compares favorably with recent shipments of the STS lithotripters due to cost reductions built into the new system.

Recurring revenue costs of sales increased to 58% in the first quarter of 2000, compared to 52% in the same period in the prior year due to placement of a large number of new fee-for-service lithotripters as the lithotripsy delivery system continues to evolve. Overall cost of sales, as a percentage of revenue (excluding interest), increased to 61% in the first quarter of 2000 compared to 52% in the same period in the prior year due to lower margins in the equipment sales segment.

Research and development costs decreased by 21%, or \$67,000 in the first quarter of 2000 compared to the same quarter of 1999 due to the prior year's expenses connected with the completion of the Medstone STS-T transportable lithotripter.

Sales expenses increased by \$183,000 or 52% in the first quarter of 2000 when compared to the same period of 1999 due to higher commission expenses, travel expenses and advertising expenses associated with the expanded sales and marketing efforts on a wider range of products.

General and administrative expenses decreased by 1%, or \$9,000, in the first quarter of 2000 when compared to the first quarter of 1999 due to lower legal expenses in the current year due to 1999's evaluation of the Company's strategic plan mostly offset by higher costs for operations in the U.K. and consultants for the Company's efforts in seeking approval from the FDA for lithotripsy treatment of gallstones.

Gain on sale of investments was approximately \$783,000 in the three months ended March 31, 2000 with no comparable activity in the same period of the prior year due to the Company's sale of 140,167 shares of Cardiac Science, Inc. common stock and 5,000 shares of Genstar Therapeutics Corp. (formerly Urogen Corp.), both of which had a net book value of \$0.

Other expense remained consistent in the three months ended March 31, 2000 when compared to the same period of 1999 as the Company amortizes the goodwill from acquisitions over lives ranging from 15 to 40 years.

Minority interest in subsidiaries' income increased to \$191,000 in the three months ended March 31, 2000, compared to \$133,000 in the three months ended March 31, 1999 due to higher activity in the

-13-

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Northern Nevada and Southern Idaho operations.

Provision for income taxes for the first quarter of 2000 increased by \$280,600, or 80%, as a result of higher taxable income in the current year compared to the same period in the prior year.

### Liquidity and Capital Resources

-----

At March 31, 2001, the Company had cash and short-term investments of approximately \$6.4 million. These funds were generated from continuing operating activities.

As of March 31, 2001, the Company held 114,000 shares of Cardiac Science, Inc. common stock and 95,000 shares of Genstar Therapeutics Corp. common stock. The Company will continue to liquidate its holdings in these companies as markets allow.

As of May 4, 2001, the Company's holdings of Cardiac Science, Inc. common stock (114,000 shares) has an approximate market value of \$442,000. Its holdings of Genstar Therapeutics Corp. (95,000 shares) has an approximate market value of \$475,000.

The Company's long-term capital expenditure requirements will depend on numerous factors, including the progress of the Company's research and development programs, the time required to obtain regulatory approvals, the resources that the Company devotes to the development of self-funded products, proprietary manufacturing methods and advanced technologies, the costs of acquisitions and/or new revenue opportunities, the ability of the Company to obtain additional licensing arrangements and to manufacture products under those arrangements, and the demand for its products if and when approved and possible acquisitions of products, technologies and companies.

The Company believes that its existing working capital and funds anticipated to be generated from operations will be sufficient to meet the cash needs for continuation of its present operations during 2000.

### Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

Forward-looking statements in this report, including without limitation, statements relating to the Company's plans, strategies, objectives, expectations, intentions and adequacy of resources, are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Investors are cautioned that such forward-looking statements involve risks and uncertainties including without limitation the following: (i) the Company's plans, strategies, objections, expectations and intentions are subject to change at any time at the discretion of the Company, (ii) the Company's plans and results of operations will be affected by the Company's ability to manage its growth; (iii) the Company's businesses are highly competitive and the entrance of new competitors into or the expansion of the operations by existing competitors in the Company's markets and other changes could adversely affect the Company's plans and results of operations; and (iv) other risks and uncertainties indicated from time to time in the Company's filings with the Securities and Exchange Commission.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings  
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Previously reported.

Item 2. Changes in Securities  
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None

Item 3. Defaults upon Senior Securities  
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None

Item 4. Submission of Matters to a Vote of Security Holders  
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None

Item 5. Other Information  
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None

Item 6. Exhibits and Reports on Form 8-K  
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(a) The following exhibits are included herein:

None.

(b) Reports on Form 8-K.

None.

-15-

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

MEDSTONE INTERNATIONAL, INC.  
-----

A Delaware corporation

Date: May 14, 2001

/s/ Mark Selawski  
-----

Mark Selawski  
Chief Financial Officer

(Principal financial and  
accounting officer)

-16-