RECOM MANAGED SYSTEMS INC DE/
Form 10QSB
May 16, 2005

United States

Securities And Exchange Commission

Washington, D.C. 20549

FORM 10-QSB

(Mark One)

x **Quarterly Report Under Section 13 Or 15(d) Of The Securities Exchange Act Of 1934**
For The Quarterly Period Ended March 31, 2005
o **Transition Report Under Section 13 Or 15(d) Of The Securities Exchange Act Of 1934**
For The Transition Period From ________ To _______
Commission File No. _______

RECOM MANAGED SYSTEMS, INC.
(Exact name of small business issuer as specified in its charter)

Delaware	**87-0441351**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

4705 Laurel Canyon Boulevard, Suite 203
Studio City, California 91607
(818) 432-4560
(Address Of Principal Executive Offices)
(Issuer s Telephone Number)

Check whether the issuer (1) 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 x **No** o

State the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date: As of May 3, 2005, there were issued and outstanding 37,610,524 shares of common stock, par value $0.001 per share and 279,730 shares of series A preferred stock, par value $0.001 per share.

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ADVISEMENTS

Unless the context requires otherwise, *Recom* , *the company* , *we* , *us* , *our* and similar terms refer to Recom Manag Systems, Inc. Our common stock, par value $.001 per share, and our series A preferred stock, par value $.001 per share, are commonly referred to in this quarterly report as our *common shares* and *series A preferred shares* , respectively. The information in this quarterly report is current as of the date of this quarterly report (March 31, 2005), unless another date is specified.

We prepare our interim financial statements in accordance with United States generally accepted accounting principles. Our financial condition and results of operations for the three-month interim period ended March 31, 2005 are not necessarily indicative of our prospective financial condition and results of operations for the full fiscal year ended December 31, 2005. The interim financial statements presented in this quarterly report as well as other information relating to our company contained in this quarterly report should be read in conjunction with the annual financial statements and more detailed background information relating to our company and our business contained in our annual report on form 10-KSB for our fiscal year ended December 31, 2004, as it may be amended, together with any reports, statements and information filed with the SEC relating to periods or events occurring after December 31, 2004.

On April 11, 2003, we effected a split in our common shares on a 3:1 forward basis through the mechanism of a stock dividend. Whenever we make any reference in this quarterly report to the grant or issuance of common shares or options or warrants to purchase common shares, such reference shall, for comparison purposes, be made in reference to post-split numbers and, in the case of options and warrants, exercise prices, unless we state otherwise.

In this quarterly report we make a number of statements, referred to as *forward-looking statements* , which are intended to convey our expectations or predictions regarding the occurrence of possible future events or the existence of trends and factors that may impact our future plans and operating results. These forward-looking statements are derived, in part, from various assumptions and analyses we have made in the context of our current business plan and information currently available to us and in light of our experience and perceptions of historical trends, current conditions and expected future developments and other factors we believe to be appropriate in the circumstances. You can generally identify forward-looking statements through words and phrases such as *seek* , *anticipate* , *believe* , *estimate* , *expect* , *intend* , *plan* , *budget* , *project* , *may be* , *may continue* , *may likely result* , and similar e When reading any forward looking statement you should remain mindful that actual results or developments may vary substantially from those expected as expressed in or implied by that statement for a number of reasons or factors, such as those relating to: (1) the success of our research and development activities, the development of a viable commercial production model, and the speed with which regulatory authorizations and product launches may be achieved; (2) whether or not a market for our products develops and, if a market develops, the pace at which it develops; (3) our ability to successfully sell our products if a market develops; (4) our ability to attract the qualified personnel to implement our growth strategies, (5) our ability to develop sales, marketing and distribution capabilities; (6) our ability to obtain reimbursement from third party payers for the products that we sell; (7) the accuracy of our estimates and projections; (8) our ability to fund our short-term and long-term financing needs; (9) changes in our business plan and corporate strategies; and (10) other risks and uncertainties discussed in greater detail in the sections of this report, including those captioned *Plan of Operation* and *Uncertainties And Other Risk Factors That May Affect Our Future Results And Financial Condition* .

Each forward-looking statement should be read in context with, and with an understanding of, the various other disclosures concerning our company and our business made elsewhere in this report as well as other public reports we file with the United States Securities and Exchange Commission (the *SEC*), including our annual report on form 10-KSB for our fiscal year ended December 31, 2004, as it may be amended. You should not place undue reliance on any forward-looking statement as a prediction of actual results or developments. We are not obligated to update or revise any forward-looking statement contained in this report to reflect new events or circumstances unless and to the extent required by applicable law.

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RECOM MANAGED SYSTEMS, INC.

FINANCIAL STATEMENTS

FOR THE THREE MONTHS ENDED MARCH 31, 2005 AND 2004

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The accompanying notes are an integral part of these financial statements

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RECOM MANAGED SYSTEMS, INC.

(A Development Stage Company)

Balance Sheet

March 31, 2005

(Unaudited)

ASSETS		
Current assets:		
Cash and cash equivalents	$	6,511,641
Prepaid expenses and other current assets		175,444
Total current assets		6,687,085
Property and equipment, net of accumulated depreciation of $114,400.		132,079
Intangible patents, including related party amounts, net of accumulated amortization of $25,079,		347,377
TOTAL ASSETS	$	7,166,541
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$	1,227,750
Convertible debenture payable, net of unamortized debt discount of $549,003		1,450,997
Total current liabilities		2,678,747
Commitments and contingencies		
Stockholders equity:		

Series A convertible preferred stock, $.001 par value; 10,000,000 shares authorized; 193,575 shares issued and outstanding	193
Series A convertible preferred stock to be issued for accrued dividends, 87,829 shares	88
Common stock, $.001 par value; 100,000,000 shares authorized; 36,640,447 shares issued and outstanding	36,641
Additional paid-in capital	21,186,541
Deferred equity-based expense	(2,125)
Deficit accumulated during development stage	(16,733,544)
Total stockholders equity	4,487,794
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 7,166,541

The accompanying notes are an integral part of these financial statements

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RECOM MANAGED SYSTEMS, INC.

(A Development Stage Company)

Statements Of Operations

For The Three Months Ended March 31, 2005 And 2004 And From Inception

Of Development Stage (November 7, 2000) To March 31, 2005

(Unaudited)

	For the Three Months Ended March 31, 2005	2004	From Inception of Development Stage (Nov. 7, 2000) to March 31, 2005
Revenue	$	$	$
Research and development	570,380	190,255	2,798,873
General and administrative expenses	1,099,079	946,154	11,201,229
Loss before other income (expense)	(1,669,459)	(1,136,409)	(14,000,102)
Interest income	4,475		62,992
Interest expense, including amortization of debt discount	(364,718)		(379,893)
Change in fair value of warrant liability	318,000		187,570
Warrant re-pricing and other financing cost	(600,000)		(758,516)
Loss before provision for income taxes	(2,311,702)	(1,136,409)	(14,887,949)

Provision for income taxes			
Net loss	(2,311,702)	(1,136,409)	(14,887,949)
Preferred dividend	18,242	109,334	2,266,864
Net loss attributable to common stockholders	$ (2,329,944)	$ (1,245,743)	$ (17,154,813)
Basic and diluted loss per share	$ (0.07)	$ (0.03)	$ (0.72)
Basic and diluted loss per share attributable to common stockholders	$ (0.07)	$ (0.04)	$ (0.83)
Weighted average shares outstanding basic and diluted	34,992,042	33,072,549	20,592,141

The accompanying notes are an integral part of these financial statements

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RECOM MANAGED SYSTEMS, INC.

(A Development Stage Company)

Statement Of Stockholders Equity

From Inception Of Development State (November 7, 2000) To March 31, 2005

(Three Months Ended March 31, 2005 Unaudited)

	Common Stock		Series A Convertible Preferred Stock		Series A Convertible Preferred Stock To Be Issued		Additional Paid-in Capital	Deferred Compen-sation	Deficit Accumu-lated During Develop-ment Stage	Fro Incep (Nov 200 To Dec. 200
	Shares	Amount	Shares	Amount	Shares	Amount				
0:										
nce ember 00 (as ted for 3:1 split)	4,139,784	$ 4,139		$		$	$ (4,139)	$	$	
tributed tal							35,000			35,
loss									(36,673)	(36,
nce ember 31, 0	4,139,784	4,139					30,861		(36,673)	(1,
1:										
tal ributed							45,000			45,
es issued ervices July $0.033	150,000	150					4,850			5,

loss						(50,000)	(50,
nce ember 31,	4,289,784	4,289		80,711		(86,673)	(1,
2:							
tal ributed				56,400			56,
rants issued ash			305	125,000			125,
ance of mon stock							
nology Sept. 2 06	23,400,000	23,400		54,623			78,
ices ered Oct. 2 $0.021	2,925,000	2,925		17,958	(19,678)		1,
n Oct 2002 3	564,810	565		17,221			17,
n Nov 2002 6	71,250	71		189,929			190,

The accompanying notes are an integral part of these financial statements

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RECOM MANAGED SYSTEMS, INC.

(A Development Stage Company)

Statement Of Stockholders Equity

From Inception Of Development State (November 7, 2000) To March 31, 2005

(Unaudited)

(continued)

	Common Stock		Series A Convertible Preferred Stock		Series A Convertible Preferred Stock To Be Issued				Deficit Accumu-lated During Develop-ment Stage	From Inception (Nov. 7, 2000) To Dec. 31, 2004
	Shares	Amount	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Deferred Compen-sation		
Contributed ervices fficer		$		$		$	$ 20,000	$	$	20,000
Warrants ssued for ervices							5,324			5,324
Net loss		-	-						(211,954)	(211,954
Balance December 1, 2002	31,250,844	31,250					567,166	(19,678)	(298,627)	280,111
2003:										
ssuance of ommon tock for ash and ontributed roperty April 2003 2.22	112,812	113					249,887			250,000

ssuance of common stock for cash:				
May 2003 $3.00	82,667	83	247,917	248,000
May 2003 $3.33	75,075	75	249,925	250,000
ssuance of common stock for services:				
April 2003 $2.80	147,192	147	411,654	411,801
April 2003 $3.15	11,045	11	34,780	34,791
uly 2003 $3.67	111,625	112	410,192	410,304
August 2003 $3.68	33,188	33	121,103	121,136
September 2003 $3.77	24,292	24	91,673	91,697
October 2003 $4.78	15,385	15	73,525	73,540
November 2003 $3.65	18,834	19	68,783	68,802
December 2003 $3.60	5,953	6	21,425	21,431

The accompanying notes are an integral part of these financial statements

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RECOM MANAGED SYSTEMS, INC.

(A Development Stage Company)

Statement Of Stockholders Equity

From Inception Of Development State (November 7, 2000) To March 31, 2005

(Unaudited)

(continued)

	Common Stock		Series A Convertible Preferred Stock		Series A Convertible Preferred Stock To Be Issued				Deficit Accumu-lated During Develop-ment Stage	From Incepti (Nov. 2000 To Dec. 3 2004
	Shares	Amount	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Deferred Compen-sation		
hless rcise of rants	1,105,000	$ 1,105		$		$	$ (1,105)	$	$	
tributed vices cer							80,000			80,(
ployee k options ed ow market							38,400			38,4
ortization eferred npensation								6,668		6,(
ions and rants ed for:										
vices							2,196,068	(219,010)		1,977,(
ancing cost							74,088			74,(

ance of ferred k for cash			1,792,975	1,793	5,376,857			5,378,
es A ferred k offering enses					(572,785)			(572,7
ferred k eficial version ure					896,474		(896,474)	
ocation of value to rants					949,121		(949,121)	
es A ferred k accrued dend					(107,575)			(107,5
loss							(5,311,377)	(5,311,3
ance ember 31, 3	32,993,912	32,993	1,792,975	1,793	11,477,573	(232,020)	(7,455,599)	3,824,7

The accompanying notes are an integral part of these financial statements

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RECOM MANAGED SYSTEMS, INC.

(A Development Stage Company)

Statement Of Stockholders Equity

From Inception Of Development State (November 7, 2000) To March 31, 2005

(Unaudited)

(continued)

	Common Stock		Series A Convertible Preferred Stock		Series A Convertible Preferred Stock To Be Issued		Additional Paid-in Capital	Deferred Compen- sation	Deficit Accumu- lated During Develop- ment Stage	From Inception (Nov. 7, 2000) To Dec. 31, 2004
	Shares	Amount	Shares	Amount	Shares	Amount				
004:										
ssuance of ommon stock or services:										
anuary 004 $3.63	52,391	$ 52		$		$	$ 190,088	$	$	190,140
ebruary 004 $4.24	25,714	26					108,979			109,005
March 004 $4.90	47,638	48					233,584			233,632
April 004 $7.39	11,937	12					88,145			88,157
May 004 $6.66	43,425	43					289,006			289,049
une 004 $4.30	16,976	17					72,980			72,997

uly 2004 $3.90	21,583	22	84,206	84,228
August 2004 $3.56	26,885	27	95,570	95,597
September 2004 $3.67	49,035	49	179,738	179,787
October 2004 $2.67	55,420	55	148,163	148,218
November 2004 $2.94	32,635	33	95,914	95,947
December 2004 $4.52	69,504	70	313,947	314,017
Exercise of Class A warrants for cash	130,030	130	274,870	275,000
Exercise of Class C warrants for cash	16,665	17	49,979	49,996
Cashless exercise of warrants	51,815	52	(52)	
Contributed services officer			80,000	80,000

The accompanying notes are an integral part of these financial statements

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RECOM MANAGED SYSTEMS, INC.

(A Development Stage Company)

Statement Of Stockholders Equity

From Inception Of Development State (November 7, 2000) To March 31, 2005

(Unaudited)

(continued)

	Common Stock		Series A Convertible Preferred Stock		Series A Convertible Preferred Stock To Be Issued					
	Shares	Amount	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Deferred Compen-sation	Deficit Accumu-lated During Develop-ment Stage	Fro Incep (Nov 200 To Dec. 200
ization erred ensation		$		$		$	$	$ 225,531	$	22
nts for es							132,712			13
nts for nent							757,207			75
se nized epricing rrants							158,516			15
icial rsion e							408,333			40
	(369,000)	(369)					369			

lled on stock										
rsion of A red	1,546,633	1,547	(1,546,633)	(1,547)						
A red accrued nd							(295,452)			(29
s for A red nds					134,834	134	404,353			40
rsion of A red	3,457	3			(3,457)	(3)				
ss									(6,966,243)	(6,96
ce nber 31,	34,826,655	34,827	246,342	246	131,377	131	15,348,728	(6,489)	(14,421,842)	95
ce of on stock rvices:										

The accompanying notes are an integral part of these financial statements

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RECOM MANAGED SYSTEMS, INC.

(A Development Stage Company)

Statement Of Stockholders Equity

From Inception Of Development State (November 7, 2000) To March 31, 2005

(Unaudited)

(continued)

	Common Stock		Series A Convertible Preferred Stock		Series A Convertible Preferred Stock To Be Issued				Deficit Accumu-lated During Develop-ment Stage	Fr Ince (No 20 T Dec 20
	Shares	Amount	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Deferred Compen-sation		
4.26	44,205	$ 44		$		$	$ 188,259	$	$	1
y 4.05	21,231	21					85,964			
3.20	37,628	38					120,372			1
e of C s for	45,832	46					137,450			1
uted s officer							20,000			
zation rred nsation								4,364		
							27,337			

ts for s										
A ed stock . d							(18,242)			(
for A ed ds					6,081	6	18,236			
sion of A ed stock	102,396	102	(102,396)	(102)						
issued			49,629	49	(49,629)	(49)				
t ' fied eness							260,000			2
n stock	1,562,500	1,563					4,998,437			5,0
s									(2,311,702)	(2,3
e March 5	36,640,447	$ 36,641	193,575	$ 193	87,829	$ 88	$ 21,186,541	$ (2,125)	$ (16,733,544)	4,4

The accompanying notes are an integral part of these financial statements

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RECOM MANAGED SYSTEMS, INC.

(A Development Stage Company)

Statements Of Cash Flows

For The Three Months Ended March 31, 2005 And 2004 And From Inception

Of Development Stage (November 7, 2000) To March 31, 2005

(Unaudited)

	For the Three Months Ended March 31, 2005	For the Three Months Ended March 31, 2004	From Inception of Development Stage (Nov. 7, 2000) to March 31, 2005
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	$ (2,311,702)	$ (1,136,409)	$ (14,887,949)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	18,599	16,820	140,173
Amortization of debt issue costs and finance costs	324,718		338,560
Change in fair value of warrant liability	(318,000)		(187,570)
Amortization of deferred compensation	4,364	139,172	237,768
Services recognized as contributed capital	20,000	20,000	200,000
Stock issued for services	394,698	532,777	3,683,974
Options and warrants issued for services	27,337	38,981	2,254,919

Warrants issued for legal settlement			757,207
Finance cost attributed to re-pricing of warrants			158,516
Other			1,459
Changes in operating assets and liabilities:			
Prepaid expenses and other currents assets	61,462	41,064	(175,444)
Accounts payable and accrued expenses	835,629	(337,872)	1,227,751
Net cash used in operating activities	(942,895)	(685,467)	(6,250,636)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment	(4,285)	(2,589)	(247,174)
Capitalized patent cost	(19,481)	(18,174)	(294,432)
Net cash used in investing activities	(23,766)	(20,763)	(541,606)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Capital contributions			136,400
Issuance of common stock and exercise of warrants for cash	5,137,496		6,268,278
Sale of preferred stock for cash, net of expenses			4,805,865
Sale of warrants for cash			125,000

Proceeds from issuance of convertible debenture, net of expenses			1,968,340
Net cash provided by financing activities	5,137,496		13,303,883
Net increase (decrease) in cash and cash equivalents	4,170,835	(706,230)	
Cash and cash equivalents, beginning of period	2,340,806	3,957,720	6,511,641
Cash and cash equivalents, end of period	$ 6,511,641	$ 3,251,490	$ 6,511,641

The accompanying notes are an integral part of these financial statements

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RECOM MANAGED SYSTEMS, INC.

(A Development Stage Company)

Statements Of Cash Flows

For The Three Months Ended March 31, 2005 And 2004 And From Inception

Of Development Stage (November 7, 2000) To March 31, 2005

(Unaudited)

(continued)

Supplemental Cash Flow Information:

For the years from inception of development stage (November 7, 2000) to March 31, 2005, Recom paid no interest or income taxes.

Supplemental Investing and Financing Activities:

Recom recorded compensation expense of $20,000 for each of the three-month periods ended March 31, 2005 and 2004, respectively, for the Chief Executive Officer of the company. This compensation was recorded as additional paid in capital.

During the three months ended March 31, 2004, the company issued 125,743 shares of common stock for marketing and business services rendered during the period. These services were valued at $532,777 based upon the market value of the shares at the date of issuance. Of those shares issued, 52,391 shares of common stock valued at $190,140 based upon the market value of the shares at the date of issuance related to expenses accrued during the fourth quarter of 2003 since the services were rendered during that period.

For the three months ended March 31, 2005 and 2004, the company has accrued $18,242 and $109,334, respectively, in dividends related to its series A preferred stock. Such dividends are a non-cash charge as they will be paid in-kind.

During the three months ended March 31, 2005 and 2004, 102,396 and 6,667 shares of common stock, respectively, were issued upon conversion of an equivalent number of shares of series A preferred stock.

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RECOM MANAGED SYSTEMS, INC.

(A Development Stage Company)

Notes To Financial Statements

For The Three Months Ended March 31, 2005 And 2004

1.

BASIS OF PRESENTATION

The accompanying unaudited financial statements as of March 31, 2005 and for the three month periods ended March 31, 2005 and 2004 and from inception (November 7, 2000) to March 31, 2005 have been prepared by Recom pursuant to the rules and regulations of the Securities and Exchange Commission, including Form 10-QSB and Regulation S-B. The information furnished herein reflects all adjustments (consisting of normal recurring accruals and adjustments), which are, in the opinion of management, necessary to fairly present the operating results for the respective periods. Certain information and footnote disclosures normally present in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such rules and regulations. The company believes that the disclosures provided are adequate to make the information presented not misleading. These financial statements should be read in conjunction with the audited financial statements and explanatory notes for the year ended December 31, 2004 as disclosed in the company s 10-KSB for that year as filed with the SEC, as it may be amended.

The results of the three months ended March 31, 2005 are not necessarily indicative of the results to be expected for the full year ending December 31, 2005.

2.

PRO FORMA STOCK OPTION INFORMATION

Employee and Director Common Share Purchase Options Pro forma information regarding the effects on operations of employee and director common share purchase options as required by SFAS No. 123 and SFAS No. 148 has been determined as if Recom had accounted for those options under the fair value method. Pro forma information is computed using the Black Scholes method at the date of grant of the options based on the following assumptions ranges: (1) risk free interest rate of 1.42% to 3.13%; (2) dividend yield of 0%; (3) volatility factor of the expected market price of our common stock of 53.84% to 158.48%; and (4) an expected life of the options of 1.5 years. The foregoing option valuation model requires input of highly subjective assumptions. Because common share purchase options granted to employees and directors have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value of estimate, the existing model does not in the opinion of our management necessarily provide a reliable single measure of fair value of common share purchase options we have granted to our employees and directors.

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Pro forma information relating to employee and director common share purchase options is as follows:

	For the Three Months Ended March 31, 2005	For the Three Months Ended March 31, 2004
Net loss as reported	$ (2,311,702)	$ (1,136,409)
Add back stock based compensation under APB 25		
Less stock compensation calculated under SFAS 123	(145,329)	(145,223)
Pro forma net loss	$ (2,457,031)	$ (1,281,632)
Basic and diluted historical loss per share	$ (0.07)	$ (0.03)
Pro forma basic and diluted loss per share	$ (0.07)	$ (0.04)
Net loss attributable to common shares, as reported	$ (2,329,944)	$ (1,245,743)
Pro forma net loss attributable to common shares	$ (2,475,273)	$ (1,390,966)
Basic and diluted historical loss per share attributable to common shares	$ (0.07)	$ (0.04)
Pro forma basic and diluted loss per share attributable to common shares	$ (0.07)	$ (0.04)

Net Loss Per Share We use SFAS No. 128, *Earnings Per Share* for calculating the basic and diluted loss per share. We compute basic loss per share by dividing net loss and net loss attributable to common shareholders by the weighted average number of common shares outstanding. Diluted loss per share is computed similar to basic loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential shares had been issued and if the additional shares were dilutive. Common equivalent shares are excluded from the computation of net loss per share if their effect is anti-dilutive.

Per share basic and diluted net loss attributable to common stockholders amounted to $0.07 for the three months ended March 31, 2005 and $0.04 for the three months ended March 31, 2004. For the three months ended March 31, 2005 and 2004, 6,980,418 potential shares and 7,849,977 potential shares, respectively, were excluded from the shares used to calculate diluted earnings per share as their inclusion would reduce net loss per share.

3.

CONTINGENT SETTLEMENT PAYABLE

In conjunction with Dr. Budimir Drakulic becoming our Vice President and Chief Technology Officer, we reached an agreement-in-principle with Dr. Drakulic to offer to sell common shares to certain individuals in order to protect our rights to the Signal Technologies. As part of that agreement, we agreed that should we raise more than $2 million in certain offerings, we would pay 4% of the proceeds of those offerings greater than $2 million to those individuals up to a maximum amount of $480,350. We subsequently reached settlements with a number of these individuals and the remaining liability related to the agreement as of March 31, 2005 is $21,113, which is included in accounts payable and accrued expenses. See Note 7, *Commitments And Contingencies* .

4.

UNIT OFFERING

During October 2003, we sold 53.2875 units in a private placement, with each unit consisting of 33,334 series A preferred shares and 16,667 class C common share purchase warrants, at a price of $100,000 per unit. The proceeds to our company, net of expenses, were approximately $4,806,000. Each class C warrant entitles the holder to purchase

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one common share at an exercise price of $3.75 per share. The class C warrants are exercisable anytime during the four year period commencing on the final closing and do not contain provisions for cashless exercise. On October 1, 2004, we voluntarily reduced the exercise price of the class C warrants from $3.75 to $3.

Our series A preferred shares carry a liquidation value equal to $3 per share, are senior to all other shares of capital stock now existing or hereinafter created by our company as to dividend and liquidation rights, and have voting rights as if converted into common shares. Each series A preferred shareholder has the option at any time to convert all or any portion of his or her shares into common shares on a one-for-one basis. During the three months ended March 31, 2005 and 2004, 102,396 and 6,667 series A preferred shares, respectively, were converted into an equivalent number of common shares.

Our series A preferred shares are required to pay dividends of 8% annually, to be paid quarterly either in cash or in the form of additional preferred shares at the discretion of Recom. Any series A preferred shares issued as a dividend will be valued at $3 per share. During the three months ended March 31, 2005 and 2004, we accrued dividends in the amount of $18,242 and $109,334, respectively, with respect to our series A preferred shares. We have elected to pay these dividends in kind through the issuance of additional preferred stock. Through March 31, 2005, in satisfaction of the accrued dividends, we issued or committed to issue a total of 140,915 preferred shares valued at $422,729. As of March 31, 2005, 53,086 shares were issued or deemed converted into common shares. As of March 31, 2005 there are no accrued dividends payable reflected on the balance sheet.

5.

CONVERTIBLE DEBENTURE PAYABLE

On December 29, 2004, we sold an 8% convertible debenture in the amount of $2,000,000 (effective interest rate of 89%) to DKR SoundShore Oasis Holding Fund Ltd. Terms call for the payment of $400,000 in principal on the debenture in cash on May 16, 2005, June 1, 2005, July 1, 2005, August 1, 2005 and August 31, 2005, respectively. The debenture also calls for payments of interest on the outstanding principal on the debenture in cash on May 10, 2005, June 1, 2005, July 1, 2005, August 1, 2005 and August 31, 2005, respectively.

For so long as the debenture is unpaid, the debenture holder is entitled to convert the debenture into a number of common shares equal to the outstanding principal on the debenture divided by $5.25, such amount representing 105% of the closing price for our common shares on the trading day prior to the sale of the debenture. We also have the right to pay the principal and interest on the debenture in common shares in lieu of cash provided that we first register those shares with the SEC, are not otherwise in default under the debenture, and have satisfied certain other conditions including notice requirements. Should payment be made in common shares, the principal and interest under the debenture subject to conversion would be convertible into those shares at the rate of 85% of the average of the three lowest closing prices for those shares during the ten day period prior to the repayment date. If we elect to pay only interest with common shares, the conversion rate shall be fixed at 90% of the closing price immediately prior to the payment or delivery date. Under the terms of the debenture, once this registration statement is declared effective, Recom will have the right to repay both principal and interest in common shares in lieu of cash so long as we are not otherwise in default under the debenture. We filed the aforesaid registration statement on January 26, 2005, and on February 14, 2005 the SEC declared the registration statement to be effective.

While pre-payment of the debenture is generally not allowed before its August 31, 2005 due date without the consent of the debenture holder, we may do so in cash so long as we pay the entire outstanding balance due through maturity and also pays a 10% premium on the outstanding principal.

In the event of default under the debenture, including both failure to make principal and interest payments and failure to comply with various covenants, the interest rate will increase to 15%, and we will be obligated to pay the greater of (1) the principal due under the debenture together with a 30% premium, plus interest accrued; or (2) the principal due under the debenture, plus interest accrued, divided by conversion price were the debenture holder to elect to convert the debentures into common shares. As a result of the March 31, 2005 equity placement described under *Equity Transactions* , we incurred a default penalty of $600,000 at March 31, 2005, which has been accrued at March 31, 2005 and recorded as a financing cost in the statement of operations. We settled this penalty in April 2005, by agreeing to a re-pricing of the warrants described below, from an exercise price of $5.75 per share to an exercise price of $2.40 per share.

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As additional consideration for the purchase of the debenture, we granted to the debenture holder warrants entitling it to purchase 275,000 common shares at the price of $5.75 per share, or 115% of the closing price for those shares on the trading day prior to the sale of the debenture. These warrants lapse if unexercised by December 29, 2009. A registration rights agreement was executed requiring Recom to register the shares of its common stock underlying the debenture and warrant so as to permit the public resale thereof. The debenture provided for the payment of liquidated damages of 2% of the debenture balance per month if the stipulated registration deadlines were not met. In accordance with EITF 00-27, a portion of the proceeds were allocated to the warrant liability based on its fair value, which totaled $447,570 using the Black Scholes option pricing model. The remaining balance was allocated to the convertible debt instrument and was used to compute the beneficial conversion feature. We attributed a beneficial conversion feature of $408,333 to the convertible debenture based upon the difference between the effective conversion price of those shares and the closing price of our common shares on the date of issuance. The assumptions used in the Black Scholes model are as follows: (1) dividend yield of 0%; (2) expected volatility of 91%, (3) risk-free interest rate of 3.12%, and (4) expected life of 1.5 years. Additionally, we incurred legal costs of $31,660 in connection with the sale of the debenture. The total debt discount of $887,563 is being amortized over the term of the debenture. During the three months ended March 31, 2005, amortization as interest expense amounted to $324,718.

In conjunction with raising capital through the issuance of convertible debt, the Company has issued a warrant that has registration rights for the underlying shares. As the contract must be settled by the delivery of registered shares and the delivery of the registered shares is not controlled by the Company, pursuant to EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock,* the net value of the warrants at the date of issuance was recorded as a warrant liability on the balance sheet ($447,570) and the change in fair value from the date of issuance to December 31, 2004 has been included in other income (expense). The fair value of the Warrant was $578,000 at December 31, 2004. Upon the registration statement being declared effective, the fair value of the warrant on that date would be reclassified to equity.

For the three months ended March 31, 2005, the change in fair value of the warrant issued with registration rights decreased by approximately $318,000 to $260,000 at the date of effectiveness of the registration statement and is recognized as a credit to change in fair value of warrant liability on the statement of operations. At that date, the remaining fair value was credited to additional paid-in capital.

6.

EQUITY TRANSACTIONS

On January 3, 2005, we granted to our directors as compensation for serving on our audit and compensation committees share five-year purchase warrants entitling them to purchase a total of 35,000 common shares at $5.05 per share. These options vest quarterly over one year.

On January 20 2005, we issued to one director, Ms. Jennifer Black, as compensation for serving on our board of directors, options to purchase 28,000 common shares at $3.95 per share. The options vest quarterly over a period of one year, and lapse if unexercised on January 19, 2010.

Effective February 1, 2005, we approved the grant of common stock purchase options to seven non-executive employees entitling them to purchase a total of 92,000 unregistered common shares at an exercise price of $4.05 per share, representing the market price for the shares as of date of approval and grant. These options vest quarterly over a period of four year based upon the continuous provision of services and lapse, to the extent not exercised, on January 31, 2010.

On March 22 2005, we issued to one director, Ms. Lucy Duncan-Scheman, as compensation for serving on our board of directors, options to purchase 50,000 common shares at $3.10 per share. The options vest quarterly over a period of one year, and lapse if unexercised on March 21, 2010.

On March 31, 2005, we closed a private placement wherein we sold a total of 1,562,000 unregistered common shares, together with common share purchase warrants entitling the holder to purchase 1,500,000 restricted common shares, to Trellus Management Company, LLC for the sum of $5,000,000. The warrants are exercisable at $1.60 per share, contain cashless exercise provisions, and lapse if unexercised on or before March 31, 2010. As part of the transaction, we agreed to file a registration statement with the SEC on or before April 20, 2005 to register the common shares sold and the common shares issuable upon the conversion of the warrants. We further agreed to reduce the exercise price of

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the warrants to $1.20 per should we fail to file the registration statement on a timely basis. We have since procured an extension of the filing date to May 31, 2005.

During the quarter ended March 31, 2005, we issued in the aggregate 103,064 common shares for business services. These services were valued at $394,698 based upon the fair market value of the shares determined as the closing stock price as reported by the OTCBB at the date of issuance.

During the quarter ended March 31, 2005, we issued 45,832 common shares upon exercise of an equivalent number of class C warrants, for cash proceeds of $137,496.

7.

COMMITMENTS AND CONTINGENCIES

We have entered into a research and development services agreement with Battelle Memorial Institute, Health and Life Sciences to develop our Model 200 Module. Pursuant to the agreement, we have agreed to pay labor services and other expenses for performance under the agreement, estimated at $2,815,200. The term of the services to be provided is estimated to be sixteen months. Services provided will be invoiced monthly. Either party shall have the right to terminate the agreement upon 30 days written notice for any good-faith basis.

8.

RELATED PARTY TRANSACTIONS

During the three month periods ended March 31, 2005 and 2004, we incurred legal fees to a firm which has one of our directors, Mr. Ellsworth Roston, as a partner. The fees incurred for the three months of 2005 and 2004 were $36,838 and $40,448, respectively. Of these amounts, $19,481 and $18,174 was capitalized as patent costs.

On January 21, 2005, we entered into a consulting agreement with Dr. Lowell T. Harmison, on of our directors and presently our interim co-Chief Executive Officer, in connection with the provision of his services in evaluating the applicability of our technology to the EEG market. Under this agreement, we acknowledged that Dr. Harmison had previously provided services for this project for which we compensated him with the sum of $70,000 in registered common shares, and that Dr. Harmison would provide an additional $84,000 in services, payable at the rate of $16,000 per month, to complete the project over a six month term.

On March 26, 2005, Recom appointed Dr. Lowell T. Harmison as our new Chief Executive Officer in replacement of Mr. Marvin H. Fink. On March 28, 2005, Mr. Harmison replaced Mr. Fink as President. The board of directors recognized the valuable services provided to the company by Mr. Fink and acknowledged to Mr. Fink that any common share purchase options he holds by reason of serving as an officer or director of the company would be deemed fully vested by reason of those pre-retirement services. For similar reasons, the board of directors acknowledged on March 22, 2005 that Mr. Fink would be entitled to all other benefits under his employment agreement as if the contract had been lawfully and properly carried out by all parties to its full term.

9.

SUBSEQUENT EVENTS

On April 8, 2005, we closed a private placement wherein we sold a total of 937,5000 unregistered common shares, together with common share purchase warrants entitling the holder to purchase 900,000 restricted common shares, to Lagunitas Partners LP, Gruber & McBaine International, J. Patterson McBaine and Jon and Linda Gruber for the sum of $3,000,000. The warrants are exercisable at $1.60 per share, contain cashless exercise provisions, and lapse if unexercised on or before April 8, 2010. As part of the transaction, we agreed to file a registration statement with the SEC within 20 days to register the common shares sold and the common shares issuable upon the conversion of the warrants. We further agreed to reduce the exercise price of the warrants to $1.20 per should we fail to file the registration statement on a timely basis. We have since procured an extension of the filing date to May 31, 2005,

On April 15, 2005, Recom entered into a five-year employment agreement with Ms. Pamela Bunes with respect to the provision of services as our Chief Executive Officer and President and as a director of the company in connection with her appointment as our Chief Executive Officer and President on that date. The essential terms of the employment agreement are as follows: (1) Ms. Bunes is entitled to a base salary of $300,000 per year, subject to adjustment after the first anniversary of the agreement upon a performance review by the board. (2) Ms. Bunes is entitled to a $32,000

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signing bonus; and (3) Ms. Bunes is entitled to a number of employee benefits under the agreement, including the provision of an automobile and the right to participate in company benefit plans, including any bonus plans established for management or other benefit plans established for executive officers. In addition, Ms. Bunes will be granted a share purchase option entitling her to purchase 750,000 unregistered common shares at $3 per share, reflecting the closing price of our common stock as of the date of the agreement. The right to exercise the option vests quarterly in tranches of 37,500 shares per quarter over the term of the employment agreement based upon the continuous provision of services by Ms. Bunes, and lapse to the extent unexercised on April 15, 2010 with respect to the first sixteen quarterly tranches, and April 15, 2011 with respect to the final four quarterly tranches. The employment agreement provides for early termination in the case of Ms. Bunes death or disability, Ms. Bunes termination by Recom for cause as that term is defined in the agreement; and Ms. Bunes termination of employment for good reason as that term is defined in the agreement, which includes a change in control. Recom and Ms. Bunes may each also terminate the agreement upon 60 days prior notice with cause or good reason, respectively. In the event of an early termination of the agreement for any reason, all compensation and benefits under the agreement will terminate as of the date of termination, with the payment of any bonuses payable under any bonus plan adopted by the company being pro rated as of the date of termination. In additional, all unvested options shall lapse. In the event of Ms. Bunes death or in the event Recom should terminate the agreement without cause or should Ms. Bunes terminate the agreement for good reason, Recom shall also be obligated to continue to pay Ms. Bunes her base salary and to continue to provide employee benefits for a period of twelve months, except that in the event of Ms. Bunes death, this obligation shall terminated upon the expiration of the intended term of the agreement if shorter.

On April 18, 2005, Recom entered into a five-year employment agreement with Mr. Rodney Hildebrandt with respect to the provision of services as our Chief Operating Officer and Secretary and as a director of the company. The essential terms of the employment agreement are as follows: (1) The agreement has a term commencing effective as of March 22, 2005 and ending on March 21, 2010; (2) Mr. Hildebrandt is entitled to a base salary of $125,000 per year, subject to adjustment after the first anniversary of the agreement upon a performance review by the board; and (3) Mr. Hildebrandt is entitled to a number of employee benefits under the agreement, including the provision of an automobile and the right to participate in company benefit plans, including any bonus plans established for management or other benefit plans established for executive officers. In addition, Mr. Hildebrandt will be granted a share purchase option entitling him to purchase 1,000,000 unregistered common shares at $3.10 per share, reflecting the closing price of our common stock as of the date of the agreement. The right to exercise the option vests quarterly in tranches of 50,000 shares per quarter over the term of the employment agreement based upon the continuous provision of services by Mr. Hildebrandt, and lapse to the extent unexercised on April 18, 2010 with respect to the first sixteen quarterly tranches, and April 18, 2011 with respect to the final four quarterly tranches. The employment agreement provides for early termination in the case of Mr. Hildebrandt s death or disability, Mr. Hildebrandt s termination by Recom for cause as that term is defined in the agreement; and Mr. Hildebrandt s termination of employment for good reason as that term is defined in the agreement, which includes a change in control. Recom and Mr. Hildebrandt may each also terminate the agreement upon 60 days prior notice with cause or good reason, respectively. In the event of an early termination of the agreement for any reason, all compensation and benefits under the agreement will terminate as of the date of termination, with the payment of any bonuses payable under any bonus plan adopted by the company being pro rated as of the date of termination. In additional, all unvested options shall lapse. In the event of Mr. Hildebrandt s death or in the event Recom should terminate the agreement without cause or should Mr. Hildebrandt terminate the agreement for good reason, Recom shall also be obligated to continue to pay Mr. Hildebrandt his base salary and to continue to provide employee benefits for a period of twelve months, except that in the event of Mr. Hildebrandt death, this obligation shall terminated upon the expiration of the intended term of the agreement if shorter.

On April 20, 2005, we amended the terms of a common share purchase warrant we had previously granted to DKR SoundShore Oasis Holding Fund Ltd. (*Oasis*) on December 29, 2004 entitling it to purchase 275,000 common shares, by reducing the exercise price of that warrant from $5.75 per share to $2.40 per share. This amendment was effected in connection with procuring Oasis s waiver with respect to our recent issuance of $8 million in equity through two private placements as discussed above. See Note 5, *Convertible Debenture Payable* . On April 27, 2005, we notified

Oasis of our election to convert all outstanding principal and interest under their $2,000,000 8% convertible debenture into common shares, subject to the reservation of our rights to revise or revoke those elections.

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PLAN OF OPERATION

General

The following discussion of our financial condition and results of operations should be read in conjunction with (1) our interim unaudited financial statements and their explanatory notes included as part of this quarterly report, and (2) our annual audited financial statements and explanatory notes for the year ended December 31, 2004 as disclosed in our annual report on form 10-KSB for that year as filed with the SEC, as it may be amended.

Overview

Recom is a medical device company focused on researching, developing and marketing medical devices which monitor and measure physiological signals in order to detect diseases that impact an individual s health. Physiological signals are small bioelectrical signals generated by the body. Our initial product will be patient modules used as part of a heart monitor system to acquire, amplify and process physiological signals associated with a patient s cardiovascular system. Heart monitor systems are used by heart specialists known as cardiologists to collect physiological data for electrocardiogram or ECG tests for the purpose of detecting and identifying cardiovascular disease. Our patient module will operate using a proprietary and patented amplification technology which provides the capability to enlarge and process the physiological signals to discriminate them from ambient or background electromagnetic noise and to facilitate the examination of the signal data for diagnostic purposes. Our amplification technology is an enhancement of an amplification technology first developed for the United States Air Force to record bioelectrical signals from a pilot s brain, known as an electroencephalogram or EEG . Earlier versions of the technology were also used by the National Institute of Health as well as companies such as Titan Systems and Teledyne, Inc. for purposes of monitoring different physiological signals relating to the brain.

In December 2004, we completed development of a pre-production model of our first product for commercialization, our battery-operated, digital 12-lead Recom Model 100 Patient Module or *Model 100 Module* . The Model 100 Module will be used as the primary component of a 12-lead ambulatory heart monitor system, referred to as the *Model 100 Monitor System* . The Model 100 Monitor System is an ambulatory patient heart monitor or recording system that will allow a patient s heart to be continuously monitored over a period of 24 to 48 hours while the patient carries out his or her daily activities away from the physicians office or hospital. The pre-production version satisfies all performance, safety, environmental and regulatory standards. We are now in the process of conducting various user preference performance comparison tests relative to top-end ECG systems in anticipation of our planned introduction of the Model 100 Monitor System to market. We do not anticipate that we will introduce our Model 100 Monitor System to the market until March 2005, and will not start selling the device until late 2005.

Development Stage Company; Prior Going Concern Issue

We are a development stage company under the provisions of SFAS No. 7, and have negative cash flows from operations and no current established source of revenue. We do not anticipate that we will introduce our Model 100 Monitor System to the market until March 2005, and will not start selling the device until late 2005. Until recently, the foregoing matters raised substantial doubt about our ability to continue as a going concern. See note 2 to our consolidated financial statements included with our annual report on form 10-KSB for our fiscal year ended December 31, 2004. However, as a consequence of financings we recently completed in late March and early April 2005 for an aggregate of $8,000,000, management now believes that we have sufficient cash to continue our business for at least the next twelve months, and there is no going concern advisement in the notes to our interim financial statements included with this quarterly report. See *Liquidity And Capital Resources* below.

Results of Operations

We incurred a net loss before preferred dividends of $2,311,702 for our three-month interim period ended March 31, 2005, as compared to $1,136,409 for the corresponding interim period in fiscal 2004. The $1,175,293 or 103% increase in our net loss before preferred dividends for our three-month interim period ended

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March 31, 2005 was attributable to a $380,125 increase in research and development expenditures, a $642,243 increase in net other expense, and a $152,925 increase in general and administrative expense.

Research and development expenditures for our three-month interim period ended March 31, 2005 were $570,380, as compared to $190,255 for the corresponding interim period in fiscal 2004. The $380,125 or 200% increase in research and development expenditures reflected the continued ramp-up in our research and development activities, including the addition of engineering personnel. The primary components of the increase for our three-month interim period ended March 31, 2005 over the corresponding interim period in fiscal 2004 were the expenditure of an additional $293,984 in outside development costs to complete our Model 100 Module prototype; and an increase in $90,392 in compensation relating to research and development activities. These increases were partially offset by a net decrease in other expenditures.

General and administrative expenses for our three-month interim period ended March 31, 2005 were $1,099,079, as compared to $946,154 for the corresponding interim period in fiscal 2004. The primary components of general and administrative expenses for our three-month interim period ended March 31, 2005 were legal fees, general consulting fees, settlement costs and investment banking fees. The $152,925 or 16% increase in general and administrative expenses was principally attributable to a $194,233 increase in consulting fees, an $88,000 increase in non-legal professional fees, and a net increases in other general and administrative expenses, partially offset by a net $84,524 decrease in legal and accounting fees and a $139,425 decrease in investor relations fees.

We incurred net other expense in the amount of $642,243 for our three-month interim period ended March 31, 2005, as compared to $0 for the corresponding interim period in fiscal 2004. Other net expense for our three-month interim period ended March 31, 2005 was principally composed of amortization of debt discount and interest of $364,718, debt default penalty of $600,000 and change in fair value of warrant liability of $(318,000).

We also incurred preferred dividend expense of $18,242 for our three-month interim period ended March 31, 2005, as compared to $109,334 for the corresponding interim period in fiscal 2004. The $91,092 or 83% decrease in preferred dividend expense was principally attributable to a decrease in preferred shares outstanding, resulting from conversions of preferred shares into common shares.

Our net loss attributable to common stockholders increased to $2,329,944 for our three-month interim period ended March 31, 2005 as compared to $1,245,743 for the corresponding interim period in fiscal 2004. The $1,084,201 increase in net loss attributable to common stockholders was principally due to the $1,175,293 increase in our net loss before preferred dividends, offset by the aforesaid $91,092 decrease in preferred dividend expense.

Plan of Operation

Our plan of operation for the twelve month period following the date of this quarterly report is to (1) commence marketing our Model 100 Monitor System, (2) continue research and development activities relating to the development of our Model 200 Monitor System; (3) continue the evaluation process relating to establishment or acquisition of patient monitoring centers and, if the decision is made to proceed with these activities, to commence such activities; (4) to continue the investigation and potential development of our patient electrode vest and enhanced electrodes product ancillaries; and (5) complete initial studies relating to the applicability of our technology to the EEG market. We currently have budgeted $5,268,000 in costs for the twelve month period following the date of this quarterly report, including (1) $3,695,000 to cover our projected general and administrative expenses during this period; (2) $1,573,000 to cover our projected research and development costs.

Described below are the company s various research and development projects and activities that are currently in progress or which we anticipate will commence during the twelve month period following the date of this quarterly report. As noted below, we anticipate that several of these projects or activities will not be completed until after the twelve month period cited. Since the anticipated overall cost of each of these later-completed projects or activities cited below necessarily include costs anticipated to be incurred after the end of the twelve month period cited, please note that the aggregate costs for all of the projects and activities cited below exceed the $1,573,000 budgeted as stated above.

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We intend to finalize our selection of an ECG analysis software system that we will recommend for use with our Model 100 Module, as well as the necessary integration engineering to ensure that our Model 100 Module reliably and accurately produces signal data in a format compatible with that software. We anticipate we will spend approximately $250,000 to purchase the selected software packages, and an additional $50,000 to conduct the requisite integration engineering and testing activities. We anticipate we will identify and purchase the software and complete the integration engineering and testing activities by the fourth quarter of 2005. The foregoing does not include any additional expenditures or time required to modify the aforesaid standard software should that become necessary.

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We also intend to continue research and development activities with respect to our Model 200 Monitor System, patient monitoring centers and continuous preventative monitoring software project. With respect to the development of the Model 200 Module that will be the core feature of the Model 200 Monitor System, we have budgeted $2,815,000 to design, fabricate and test a pre-production model of this product under our research and development services agreement with Battelle Memorial Institute. The aforesaid estimate does not include the cost to establish or acquire patient monitoring centers. Pending the completion of the introduction of our Model 100 Module to the market during the balance of fiscal 2005, we intend to reduce the activities on the Model 200 project to minimal levels and have budgeted $206,000 toward the project over the next twelve months.

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We also intend to continue investigation and development work on our patient vest. We project that we will spend approximately $230,000 to conduct these development activities, and expect to complete them by the last quarter of 2005.

Included in our anticipated general and administrative expenses for the twelve month period following the date of this quarterly report is approximately $500,000 in sales and marketing expenses. These funds will be targeted among other things toward:

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hiring additional sales and marketing personnel;

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conducting evaluation studies of our Model 100 Module at various hospitals, clinics and research institutions for the purpose of evaluating our Model 100 Monitor System in a patient setting in order to identify and optimize the performance, usability and aesthetic aspects of the system for marketing purposes (we are presently conducting our initial studies at the Duke Clinical Research, and are presently negotiating our second study at the Cleveland Clinic);

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exhibiting our Model 100 Module at various trade shows (including shows for the North American Society for Pacing and Electrophysiology, American College of Cardiology and American Heart Association);

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providing sample heart monitor systems to key cardiologists, hospitals and monitoring centers;

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commencing an advertising program in cardiology journals; and

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coordinating the writing of a number of technical papers relating to the effectiveness of our Model 100 Module Monitor system, to be presented at technical conferences and/or published in peer-reviewed scientific and medical journals.

Also included in our anticipated general and administrative expenses for the twelve month period following the date of this quarterly report is approximately $370,000 in production expense relating to the commercial production of our Model 100 Module, to include hiring a third-party contract manufacturer to fabricate the device.

We anticipate that we will add between two and five additional employees to our staff during the twelve month period following the date of this quarterly report.

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We can give you no assurance that we will be successful in developing our modules, patient vest or enhanced electrodes at all or within the timeframes or at the costs estimated, or in procuring FDA approval or clearance for these products when necessary, or in designing and engineering durable, reliable and competitively priced production versions of any of these products.

Our anticipated costs and project completion dates described above are estimates based upon our current business plan. Our actual costs or actual project completion dates could vary materially from those estimated. We may also decide at any time to terminate our ongoing development plans with respect to ancillary products such as our patient vests, enhanced electrodes and proprietary software should we deem them to be impracticable or not be commercially viable. Further changes to our current business plan could also result, such as the acquisition of new products or services or the decision to manufacture our own products, resulting in a change in our anticipated. See that section of this quarterly report captioned *Advisements* . At this point our new management team is re-evaluating our core business plan as it relates to our heart monitor products, including redefining the market for our Model 100 Monitoring System and accelerating the introduction of that product to market, and re-evaluating the development methodology for our Model 200 Module.

Liquidity and Capital Resources

Historical Sources of Capital Resources

As reported in our audited financial statements for the year ended December 31, 2004 included as part of this quarterly report, for the period January 1, 2003 through December 31, 2004, we principally financed our operations through a combination of (1) gross proceeds from contributed capital, the sale of our common shares, series A preferred shares and common share purchase warrants for cash, and the exercise of stock purchase warrants for cash ($6,301,645); (2) the issuance of common shares or common share purchase warrants in payment of the provision of services ($5,938,893); and (3) gross proceeds from the sale of a debenture and common share purchase warrants ($2,000,000). Included in the foregoing are the following significant transactions:

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From October through December 2003, we raised $5,378,650 in gross proceeds from a private placement to 100 investors effected through Maxim Group, LLC, a registered broker-dealer, as placement agent, pursuant to which we sold 1,792,976 series A convertible preferred shares, with each share convertible into one common share; and 896,488 Class C warrants, each warrant entitling the holder to purchase one common share for $3.75 (later voluntarily reduced by the company to $3).

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On December 29, 2004, we sold an 8% convertible debenture in the amount of $2,000,000 to DKR SoundShore Oasis Holding Fund Ltd. Subject to our right to convert the debenture into common shares as discussed below, we are obligated to pay $400,000 in principal on the debenture in cash on May 16, 2005, June 1, 2005, July 1, 2005, August 1, 2005 and August 31, 2005, respectively. We are also obligated to pay 8% in interest on the outstanding principal on the debenture in cash on May 10, 2005, June 1, 2005, July 1, 2005, August 1, 2005 and August 31, 2005, respectively. On January 26, 2005, we filed a registration statement to register common shares issuable upon the conversion of the debenture as discussed below, and it was declared effective by the SEC on February 14, 2005. Accordingly, under the terms of the debenture we are also entitled to pay the principal and interest on the debenture in common shares in lieu of cash so long as we are not otherwise in default under the debenture, and have satisfied certain other conditions including notice requirements.

For so long as the debenture is unpaid, the debenture holder is entitled to convert the debenture into a number of common shares equal to the outstanding principal on the debenture divided by $5.25, such amount representing 105% of the closing price for our common shares on the trading day prior to the sale of the debenture.

Should we elect to make payment in common shares as provided above, the principal and interest under the debenture subject to conversion would be convertible into those shares at the rate of 85% of the average of the three lowest closing prices for those shares during the ten day period prior to the repayment date. If we only

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elect to pay interest with common shares, the conversion rate shall be fixed at 90% of the closing price immediately prior to the payment or delivery date.

While we are not generally allowed to pre-pay the debenture before its August 31, 2005 due date without the consent of the debenture holder, we may do so in cash so long as we pay the entire outstanding balance due through maturity and also pays a 10% premium on the outstanding principal.

In the event of our default under the debenture, including both our failure to make principal and interest payments and our failure to comply with various covenants, the interest rate will increase to 15%, and we will be obligated to pay the greater of (1) the principal due under the debenture together with a 30% premium, plus interest accrued; or (2) the principal due under the debenture, plus interest accrued, divided by conversion price were the debenture holder to elect to convert the debentures into company common shares.

As additional consideration for the purchase of the debenture, we also granted to the debenture holder warrants entitling it to purchase 275,000 common shares at the price of $5.75 per share, or 115% of the closing price for those shares on the trading day prior to the sale of the debenture. These warrants lapse if unexercised by December 29, 2009. As the result of such grant, we have recorded a non-cash deferred financing charge in the amount of $447,570 reflecting the fair value attributable to these warrants. We have also recorded a non-cash beneficial conversion feature of $408,333, based upon the difference in the effective conversion price of the debenture and the closing price of our common stock on the date of issuance. As a result of these non-cash charges the effective annual rate of interest on the debenture is 89%.

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On March 31, 2005, we sold a total of 1,562,500 unregistered common shares, together with common share purchase warrants entitling the holder to purchase 1,500,000 restricted common shares, to Trellus Partners, LP for the sum of $5,000,000 pursuant to a private placement. The warrants are exercisable at $1.60 per share, contain cashless exercise provisions, and lapse if unexercised on or before March 31, 2010.

Since the period described above, we have entered into the following transactions:

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On April 8, 2005, we sold a total of 937,500 unregistered common shares, together with common share purchase warrants entitling the holder to purchase 900,000 restricted common shares, to Lagunitas Partners LP, Gruber & McBaine International, Jon D. and Linda W. Gruber, and J. Patterson McBaine for the sum of $3,000,000 pursuant to a private placement. The warrants are exercisable at $1.60 per share, contain cashless exercise provisions, and lapse if unexercised on or before April 8, 2010.

Liquidity

We have approximately $8,990,000 of cash on hand as of April 30, 2005 to fund our operations going forward. As discussed above, our plan of operation for the twelve month period following the date of this quarterly report is to commence our marketing activities with respect to our Model 100 Module, and to continue product development activities with respect to our Model 200 Module, and we have budgeted $5,268,000 in costs for this twelve month period. We believe that our cash on hand will be sufficient to cover these anticipated expenditures. In order to preserve our cash flow, we intend to convert the principal and interest on our $2,000,000 debenture with Oasis into common shares. Should our costs and expenses prove to be greater than we currently anticipate, or should we change our current business plan in a manner that will increase or accelerate our anticipated costs and expenses, such as through an acquisition of new products, the depletion of our working capital would be accelerated. To the extent it becomes necessary to raise additional cash in the future as our current cash and working capital resources are depleted, we will seek to raise it through the public or private sale of debt or equity securities, the procurement of advances on contracts or licenses, funding from joint-venture or strategic partners, debt financing or short-term loans, or a combination of the foregoing. We may also seek to satisfy indebtedness without any cash outlay through the private issuance of debt or equity securities. We currently do not have any binding commitments for, or readily available sources of, additional financing. We cannot give you any assurance that we will be able to secure the additional cash or working capital we may require to continue our operations.

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Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. For a description of those estimates, see note 2, *Significant Accounting Policies*, contained in the explanatory notes to our audited financial statements for the year ended December 31, 2004 contained in our annual report on form 10-KSB for that year, as it may be amended. On an ongoing basis, we evaluate our estimates, including those related to reserves, deferred tax assets and valuation allowance, impairment of long-lived assets, fair value of equity instruments issued to consultants for services and estimates of costs to complete contracts. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions; however, we believe that our estimates, including those for the above-described items, are reasonable.

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No.153, *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions* . The amendments made by Statement 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. Previously, Opinion 29 required that the accounting for an exchange of a productive asset for a similar productive asset or an equivalent interest in the same or similar productive asset should be based on the recorded amount of the asset relinquished. Opinion 29 provided an exception to its basic measurement principle (fair value) for exchanges of similar productive assets. The FASB believes that exception required that some nonmonetary exchanges, although commercially substantive, be recorded on a carryover basis. By focusing the exception on exchanges that lack commercial substance, the FASB believes this statement produces financial reporting that more faithfully represents the economics of the transactions. SFAS 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date of issuance. The provisions of SFAS 153 shall be applied prospectively. Recom has evaluated the impact of the adoption of SFAS 153, and does not believe the impact will be significant to the company s overall results of operations or financial position.

In December 2004, the FASB issued SFAS No.123 (revised 2004), *Share-Based Payment* . SFAS 123(R) will provide investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. SFAS 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS 123(R) replaces FASB Statement No. 123, *Accounting for Stock-Based Compensation* , and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees* . SFAS 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that statement permitted entities the option of continuing to apply the guidance in Opinion 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. Public entities (other than those filing as small business issuers) will be required to apply SFAS 123(R) as of the first interim or annual reporting period that begins after June 15, 2005. SFAS 123(R) is applicable for Recom effective the first interim period that starts after December 15, 2005. Recom has evaluated the impact of the adoption of SFAS 123(R), and believes that the impact will be significant to the company s overall results of operations and financial position (a pro forma effect, as estimated by management, is disclosed in note 2 of our financial statements).

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In December 2004 the Financial Accounting Standards Board issued two FASB Staff Positions FSP FAS 109-1, *Application of FASB Statement 109 Accounting for Income Taxes to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004,* and FSP FAS 109-2 *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004.* Neither of these affected the Company as it does not participate in the related activities

In January 2003, the FASB issued FASB Interpretation No. (FIN) 46, Consolidation of Variable Interest Entities (FIN 46). In December 2003, FIN 46 was replaced by FASB interpretation No. 46(R) Consolidation of Variable Interest Entities . FIN 46(R) clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46(R) requires an enterprise to consolidate a variable interest entity if that enterprise will absorb a majority of the entity s expected losses, is entitled to receive a majority of the entity s expected residual returns, or both. FIN 46(R) is effective for entities being evaluated under FIN 46(R) for consolidation no later than the end of the first reporting period that ends after March 15, 2004. The Company does not currently have any variable interest entities that will be impacted by adoption of FIN 46(R).

UNCERTAINTIES AND OTHER RISK FACTORS THAT MAY AFFECT OUR FUTURE RESULTS AND FINANCIAL CONDITION

Our future results of operations or financial condition and your investment in our common shares may be adversely affected by the uncertainties and other risk factors enumerated below as well as those presented elsewhere in this quarterly report and in other reports we periodically file with the SEC, including our annual report on form 10-KSB for the fiscal year ended December 31, 2004, as it may be amended from time to time, and should be considered in context with the various disclosures concerning our company presented elsewhere herein and therein.

Risks Relating To Our Business

Our limited operating history will make it difficult for you to predict our future operating results and to otherwise assess or predict the likelihood of our business success.

To date, we are a development stage company principally engaged in research and development, organizational and startup activities which has not yet introduced our heart monitoring products to market. Our limited operating history will make it difficult, if not impossible, to predict future operating results and to assess the likelihood of our business success in considering an investment in our company. Risks and issues inherent in the establishment and expansion of a new business enterprise which we face include, among others, problems of entering new markets, marketing new technologies, hiring and training personnel, acquiring reliable facilities and equipment, and implementing operational controls. As a development stage company, we are also subject to risks and or levels of risk that are often greater than those encountered by companies with established operations and relationships. Development stage companies often require significant capital from sources other than operations. Since we are a start-up business, our management and employees will shoulder the burdens of the business operations and a workload associated with company growth and capitalization that is disproportionately greater than that for an established business. We cannot give you any assurance that we will successfully address these risks. Our prospects must be considered speculative, which may limit our ability to encourage further investment in our company.

We have no revenues to date and have accumulated losses since our inception. Our continued inability to generate revenues and profits could cause us to go out of business.

We have incurred cumulative net losses after preferred dividends available to common shareholders in the amount of $17,154,813 from our inception through March 31, 2005, and have debt of $2,000,000 maturing in increments by August 31, 2005 although we have notified the holder of the debenture that we intend to convert the principal and interest on that indebtedness into common shares. We have no commercial product sales or revenues to date, and do not anticipate that we will commence commercial sales of our heart monitoring products until late 2005. Once we

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commence marketing our heart monitoring products, we project that we will not be cash flow positive based solely on projected sales and service revenues less manufacturing, general and administrative, marketing expenses and other operating costs for an indefinite period of time. We anticipate that we will continue to incur substantial operating losses for the foreseeable future, notwithstanding any anticipated revenues we may receive when our products are initially introduced to markets, due to the significant costs associated with the development and marketing of our products and services.

If we are unable to raise additional working capital, we will be unable to fully fund our operations and to otherwise execute our business plan, leading to the reduction or suspension of our operations and ultimately our going out of business.

As noted in the prior risk factor, we do not anticipate that we will commence commercial sales of our heart monitoring products until late 2005, and further anticipate that after such introduction we will continue to be cash flow negative due to our costs exceeding our revenues for an indefinite period of time. We believe that our currently available working capital will be sufficient to continue our business for at least the next twelve months. Should our costs and expenses prove to be greater than we currently anticipate, or should we change our current business plan in a manner that will increase or accelerate our anticipated costs and expenses, such as through an acquisition of new products, the depletion of our working capital would be accelerated. To the extent it become necessary to raise additional cash in the future as our current cash and working capital resources are depleted, we will seek to raise it through the public or private sale of debt or equity securities, the procurement of advances on contracts or licenses, funding from joint-venture or strategic partners, debt financing or short-term loans, or a combination of the foregoing. We may also seek to satisfy indebtedness without any cash outlay through the private issuance of debt or equity securities. We currently do not have any binding commitments for, or readily available sources of, additional financing. We cannot give you any assurance that we will be able to secure the additional cash or working capital we may require to continue our operations.

Even if we are able to raise additional financing, we might not be able to obtain it on terms that are not unduly expensive or burdensome to the company or disadvantageous to our existing shareholders.

Even if we are able to raise additional cash or working capital through the public or private sale of debt or equity securities, the procurement of advances on contracts or licenses, funding from joint-venture or strategic partners, debt financing or short-term loans, or the satisfaction of indebtedness without any cash outlay through the private issuance of debt or equity securities, the terms of such transactions may be unduly expensive or burdensome to the company or disadvantageous to our existing shareholders. For example, we may be forced to sell or issue our securities at significant discounts to market, or pursuant to onerous terms and conditions, including the issuance of preferred stock with disadvantageous dividend, voting or veto, board membership, conversion, redemption or liquidation provisions; the issuance of convertible debt with disadvantageous interest rates and conversion features; the issuance of warrants with cashless exercise features; the issuance of securities with anti-dilution provisions; and the grant of registration rights with significant penalties for the failure to quickly register. If we raise debt financing, we may be required to secure the financing with all of our business assets, which could be sold or retained by the creditor should we default in our payment obligations. We also might be required to sell or license our products or technologies under disadvantageous circumstances we would not otherwise consider, including granting licenses with low royalty rates and exclusivity provisions.

Our products are highly regulated. We will not be able to introduce our products to market if we cannot obtain the necessary regulatory approvals. If we are unable to obtain regulatory approvals for our products in selected key markets at all or in a timely manner, we will not be able to grow as quickly as expected, and the loss of anticipated revenues will also reduce our ability to fully fund our operations and to otherwise execute our business plan. Our failure to receive the regulatory approvals in the United States would likely cause us to go out of business.

The manufacture, sale, promotion and marketing of our heart monitoring products and other products we intend to develop are subject to regulation by the FDA and similar government regulatory bodies in other countries. As we develop or obtain new products we will be required to determine what regulatory requirements, if any, we must

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comply with in order to market and sell our products in the United States and worldwide. The process of obtaining regulatory approval could take years and be very costly, if approval can be obtained at all. If we fail to comply with these requirements, we could be subjected to enforcement actions such as an injunction to stop us from marketing the product at issue or a possible seizure of our assets. We intend to work diligently to assure compliance with all applicable regulations that impact our business. We can give you no assurance, however, that we will be able to obtain regulatory approval for all of our products. We also cannot assure you that additional regulations will not be enacted in the future that would be costly or difficult to satisfy.

Because we are not diversified, we are subject to a greater risk of going out of business should our single proposed product line fail.

The only business opportunities we are presently pursuing are the heart monitoring or ECG market and, later, using the same technology, the neurological brain scan or EEG market. Unlike many established companies that are diversified, we do not presently have other businesses, properties, investments or other income producing assets upon which we could rely upon should our single product line fail, thereby increasing the risk of our going out of business.

Many of our customers will rely upon third party reimbursements from third party payors to cover all or a portion of the cost of our products. If third party payors do not provide reimbursement for our products, we will not be able to grow as quickly as expected, and the loss of anticipated revenues will also reduce our ability to fully fund our operations and to otherwise execute our business plan.

We intend to sell our heart monitoring products to individual patients and doctors, hospitals and clinics who will seek reimbursement from various third party payers, including government health programs, private health insurance plans, managed care organizations and other similar programs. We can give you no assurance that reimbursement will be available from third party payers at all, or for more than a nominal portion of the cost of our products.

We intend to rely upon licensees, strategic partners or third party marketing and distribution partners to provide a significant part of our marketing and sales functions. Should these outside parties fail to perform as expected, we will need to develop or procure other marketing and distribution channels, which would cause delays or interruptions in our product supply and result in the loss of significant sales or customers.

We currently have no internal sales, marketing and distribution capabilities, and will rely extensively on third-party licensees, strategic partners or third party marketing and distribution companies to perform a significant part of those functions. As a consequence of that reliance, our ability to effectively market and distribute our products will be dependent in large part on the strength and financial condition of others, the expertise and relationships of those third-parties with customers, and the interest of those parties in selling and marketing our products. Prospective third-party licensees, strategic partners and marketing and distribution parties may also market and distribute the products of other companies. If our relationships with any third-party licensees, strategic partners or marketing and distribution partners were to terminate, we would need to either develop alternative relationships or develop our own internal sales and marketing forces to continue to sell our products. Even if we are able to develop our internal sales, marketing and distribution capabilities, these efforts would require significant cash and other resources that would be diverted from other uses, if available at all, and could cause delays or interruptions in our product supply to customers, which could result in the loss of significant sales or customers. We can give you no assurance that we will be successful in our efforts to engage licensees, strategic partners or third party marketing and distribution companies to meet our sales, marketing and distribution requirements.

We intend to rely upon the third-party FDA-approved manufacturers or suppliers to manufacture our heart monitoring products. Should these manufacturers fail to perform as expected, we will need to develop or procure other manufacturing sources, which would cause delays or interruptions in our product supply and result in the loss of significant sales and customers.

We currently have no internal manufacturing capability, and will rely extensively on FDA-approved licensees, strategic partners or third party contract manufacturers or suppliers. Should we be forced to manufacture our

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products, we cannot give you any assurance that we will be able to develop an internal manufacturing capability or procure third party suppliers. Moreover, we cannot give you any assurance that any contract manufacturers or suppliers we procure will be able to supply our product in a timely or cost effective manner or in accordance with applicable regulatory requirements or our specifications.

We are dependent for our success on a few key executive officers. Were we to lose one or more of these key executive officers, we would be forced to expend significant time and money in the pursuit of a replacement, which would result in both a delay in the implementation of our business plan and the diversion of working capital.

Our success depends to a critical extent on the continued efforts of services of our executive management team comprised of Ms. Pamela Bunes, our permanent Chief Executive Officer and President, Mr. Rodney Hildebrandt, our Chief Operating Officer, and Dr. Budimir S. Drakulic, our Vice President and Chief Technology Officer. Were we to lose one or more of these key executive officers, we would be forced to expend significant time and money in the pursuit of a replacement, which would result in both a delay in the implementation of our business plan and the diversion of working capital. Ms. Bunes and Mr. Hildebrandt are currently employed pursuant to five-year employment agreements, while Dr. Drakulic is employed as a consultant under a loan-out agreement through October 15, 2012. None of these agreements will preclude any of these key officers from leaving the company. We currently maintain key man life insurance policies in the amount $3 million with respect to Dr. Drakulic which will assist us in recouping some of our costs in the event of the death of that officer.

Our inability to protect our intellectual property rights could allow competitors to use our property rights and technologies in competition against our company, which would reduce our sales. In such an event we would not be able to grow as quickly as expected, and the loss of anticipated revenues will also reduce our ability to fully fund our operations and to otherwise execute our business plan.

We rely on a combination of patent, patent pending, copyright, trademark and trade secret laws, proprietary rights agreements and non-disclosure agreements to protect our intellectual properties. We cannot give you any assurance that these measures will prove to be effective in protecting our intellectual properties. We also cannot give you any assurance that our existing patents will not be invalidated, that any patents that we currently or prospectively apply for will be granted, or that any of these patents will ultimately provide significant commercial benefits. Further, competing companies may circumvent any patents that we may hold by developing products which closely emulate but do not infringe our patents. While we intend to seek patent protection for our products in selected foreign countries, those patents may not receive the same degree of protection as they would in the United States. We can give you no assurance that we will be able to successfully defend our patents and proprietary rights in any action we may file for patent infringement. Similarly, we can give you any assurance that we will not be required to defend against litigation involving the patents or proprietary rights of others, or that we will be able to obtain licenses for these rights. Legal and accounting costs relating to prosecuting or defending patent infringement litigation may be substantial.

We also rely on proprietary designs, technologies, processes and know-how not eligible for patent protection. We cannot give you any assurance that our competitors will not independently develop the same or superior designs, technologies, processes and know-how.

While we have and will continue to enter into proprietary rights agreements with our employees and third parties giving us proprietary rights to certain technology developed by those employees or parties while engaged by our company, we can give you no assurance that courts of competent jurisdiction will enforce those agreements.

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Risks Relating To An Investment In Our Securities

Our common shares are sporadically or thinly traded, so you may be unable to sell at or near ask prices or at all if you need to sell your shares to raise money or otherwise desire to liquidate your shares

Our common shares have historically been sporadically or thinly traded on the OTCBB, meaning that the number of persons interested in purchasing our common shares at or near ask prices at any given time may be relatively small or non-existent. This situation is attributable to a number of factors, including the fact that we are a small company which is relatively unknown to stock analysts, stock brokers, institutional investors and others in the investment community that generate or influence sales volume, and that even if we came to the attention of such persons, they tend to be risk-averse and would be reluctant to follow an unproven development stage company such as ours or purchase or recommend the purchase of our shares until such time as we became more seasoned and viable. As a consequence, there may be periods of several days or more when trading activity in our shares is minimal or non-existent, as compared to a seasoned issuer which has a large and steady volume of trading activity that will generally support continuous sales without a material reduction in share price. We cannot give you any assurance that a broader or more active public trading market for our common shares will develop or be sustained, or that current trading levels will be sustained. Due to these conditions, we can give you no assurance that you will be able to sell your shares at or near ask prices or at all if you need money or otherwise desire to liquidate your shares.

The market price for our common shares is particularly volatile given our status as a relatively unknown development stage company with a small and thinly-traded public float, limited operating history and lack of revenues or profits to date for our newly introduced products, which could lead to wide fluctuations in our share price. The price at which you purchase our common shares may not be indicative of the price that will prevail in the trading market. You may be unable to sell your common shares at or above your purchase price, which may result in substantial losses to you. The volatility in our common share price may subject us to securities litigation.

The market for our common shares is characterized by significant price volatility when compared to seasoned issuers, and we expect that our share price will continue to be more volatile than a seasoned issuer for the indefinite future. The volatility in our share price is attributable to a number of factors. First, we have relatively few common shares outstanding in the public float since most of our shares are held by a small number of shareholders. In addition, as noted above, our common shares are sporadically or thinly traded. As a consequence of this lack of liquidity, the trading of relatively small quantities of shares by our shareholders may disproportionately influence the price of those shares in either direction. The price for our shares could, for example, decline precipitously in the event that a large number of our common shares are sold on the market without commensurate demand, as compared to a seasoned issuer which could better absorb those sales without a material reduction in share price. Secondly, we are a speculative or risky investment due to our limited operating history and lack of revenues or profits to date, and uncertainty of future market acceptance for our products. As a consequence of this enhanced risk, more risk-adverse investors may, under the fear of losing all or most of their investment in the event of negative news or lack of progress, be more inclined to sell their shares on the market more quickly and at greater discounts than would be the case with the stock of a seasoned issuer. Additionally, in the past, plaintiffs have often initiated securities class action litigation against a company following periods of volatility in the market price of its securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs and liabilities and could divert management s attention and resources.

The following factors may add to the volatility in the price of our common shares: actual or anticipated variations in our quarterly or annual operating results; acceptance of our products and services as viable security and technology solutions; government regulations, announcements of significant acquisitions, strategic partnerships or joint ventures; our capital commitments; and additions or departures of our key personnel. Many of these factors are beyond our control and may decrease the market price of our common shares, regardless of our operating performance. We cannot make any predictions or projections as to what the prevailing market price for our common shares will be at any time, including as to whether our common shares will sustain their current market prices, or as to what effect that the sale of shares or the availability of common shares for sale at any time will have on the prevailing market price.

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Since a single shareholder currently beneficially owns the majority of our outstanding common shares, that single shareholder will retain the ability to control our management and the outcome of corporate actions requiring shareholder approval notwithstanding the overall opposition of our other shareholders. This concentration of ownership could discourage or prevent a potential takeover of our company that might otherwise result in you receiving a premium over the market price for your common shares.

ARC Finance Group, LLC, which is owned and controlled by Ms. Tracey Hampton, owns a majority of our outstanding common shares. As a consequence of its controlling stock ownership position, ARC Finance Group retains the ability to elect a majority of our board of directors or to remove any director, and thereby controls our management. ARC Finance Group also has the ability to control the outcome of corporate actions requiring shareholder approval, including mergers and other changes of corporate control, going private transactions, and other extraordinary transactions. ARC Finance actively evaluates potential modifications to our board of directors and management, and could make such modifications or wholesale changes at any time if deemed to be in the company s best interest.

The sale of a large amount of common shares held by our shareholders or our executive officers or directors, or the perception that such sales could occur, could substantially depress the prevailing market prices for our shares.

The ability of our majority shareholder, ARC Finance Group, LLC, to sell common shares under Rule 144 is unclear under current SEC interpretations relating to eligibility for use of that safe harbor. As a consequence, we intend to register approximately 3,500,000 common shares held by ARC Finance Group for resale to provide it with a mechanism to sell such shares on the public market in the future should it decide to do so, without waiving the right of ARC Finance Group to sell common shares under Rule 144. We have also previously registered large amounts of common shares for selling shareholders, including a large amount of common shares issuable to Oasis upon its exercise of common share purchase warrants as well as common shares issuable upon our anticipated conversion of our $2,000,000 debenture with Oasis into common shares. We are also under an obligation to register shares issuable in connection with recent private placements of our common shares and common share purchase warrants. Some of our executive officers and directors also hold large amounts of common shares that they may sell under Rule 144 subject to control stock volume limitations. We intend to register these shares under a resale prospectus contained in a registration statement on form S-8, which would increase the overall number of such shares that those officers and directors may sell on the public markets subject to volume restrictions imposed under form S-8. Some of our executive officers and directors also hold common stock purchase options entitling them to acquire large amounts of common shares. We also intend to register these shares under a resale prospectus contained in a registration statement on form S-8, which would provide those officers and directors with a mechanism to immediately sell such shares on the public markets subject to volume restrictions imposed under form S-8.

A large number of common shares are issuable upon conversion of our series A preferred shares or the exercise of outstanding common share purchase options or warrants. The conversion or exercise of these securities could result in the substantial dilution of your investment in terms of your percentage ownership in the company as well as the book value of your common shares. The sale of a large amount of common shares received upon the conversion or exercise of these securities on the public market to finance the exercise price or to pay associated income taxes, or the perception that such sales could occur, could substantially depress the prevailing market prices for our shares.

There are currently outstanding as of May 3, 2005, 279,730 series A preferred shares each convertible into one common share at the conversion rate of $3 per share, and common share purchase options and warrants entitling the holders to purchase 8,788,770 common shares at a weighted average exercise price of $2.22 per share, including a number granted to directors, officers, employees and consultants that are subject to vesting conditions. In the event of the conversion or exercise of these securities, you could suffer substantial dilution of your investment in terms of your percentage ownership in the company as well as the book value of your common shares. In addition, the holders of the common share purchase options or warrants may sell common shares in tandem with their exercise of those options or warrants to finance that exercise, or may resell the shares purchased in order to cover any income tax liabilities that may arise from their conversion or exercise of these securities.

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Our issuance of additional common shares or preferred shares, or options or warrants to purchase those shares, would dilute your proportionate ownership and voting rights. Our issuance of additional preferred shares, or options or warrants to purchase those shares, could negatively impact the value of your investment in our common shares as the result of preferential voting rights or veto powers, dividend rights, disproportionate rights to appoint directors to our board, conversion rights, redemption rights and liquidation provisions granted to the preferred shareholders, including the grant of rights that could discourage or prevent the distribution of dividends to you, or prevent the sale of our assets or a potential takeover of our company that might otherwise result in you receiving a distribution or a premium over the market price for your common shares.

We are entitled under our certificate of incorporation to issue up to 100,000,000 common and 10,000,000 blank check preferred shares. After taking into consideration our outstanding common and preferred shares as of May 3, 2005, we will be entitled to issue up to 62,389,476 additional common shares and 9,720,270 additional preferred shares. Our board may generally issue those common and preferred shares, or options or warrants to purchase those shares, without further approval by our shareholders based upon such factors as our board of directors may deem relevant at that time. Any preferred shares we may issues shall have such rights, preferences, privileges and restrictions as may be designated from time-to-time by our board, including preferential dividend rights, voting rights, conversion rights, redemption rights and liquidation provisions. It is likely that we will be required to issue a large amount of additional securities to raise capital to further our development and marketing plans. It is also likely that we will be required to issue a large amount of additional securities to directors, officers, employees and consultants as compensatory grants in connection with their services, both in the form of stand-alone grants or under our various stock plans. We cannot give you any assurance that we will not issue additional common or preferred shares, or options or warrants to purchase those shares, under circumstances we may deem appropriate at the time.

LEGAL PROCEEDINGS

As of the date of this quarterly report, there are no material pending legal or governmental proceedings relating to our company or properties to which we are a party, and to our knowledge there are no material proceedings to which any of our directors, executive officers or affiliates are a party adverse to us or which have a material interest adverse to us.

CHANGES IN SECURITIES AND USE OF PROCEEDS

Modification Of Instruments Defining Rights Of Holders Of Class Of Registered Securities

Not Applicable

Limitation Or Qualification Of Rights Of Class of Registered Securities By Issuance Or Modification Of Any Other Class Of Securities

Not Applicable

Recent Sales Of Unregistered Equity Securities

Rule 506

During the three-month interim period ended March 31, 2005, we sold or issued the following securities not registered under the Securities Act of 1933 by reason of the exemption afforded under SEC Rule 506 of Regulation D promulgated under Section 4(2) of the Securities Act. The offer and sale of the securities in each offering was exempt from the registration requirements of the Securities Act under Rule 506 insofar as: (1) except as stated below, each of the investors was accredited within the meaning of Rule 501(a); (2) pursuant to Rule 506(b)(2)(i), there were no more than 35 non-accredited investors in the offering; (3) pursuant to

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Rule 506(b)(2)(ii), each purchaser in the offering who was not accredited either alone or with his purchaser representative had such knowledge and experience in financial and business matters to be capable of evaluating the merits and risk of the investment, or the company reasonably believed immediately prior to making the sale that such investor came with this description; (4) no offers or sales under the offering was effected through any general solicitation or general advertising within the meaning of Rule 502(c); and (5) the transfer of the securities in the offering were restricted by the company in accordance with Rule 502(d). Except as stated below, no underwriting discounts or commissions were payable with respect to any of the offerings.

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On January 3 2005, we issued to three directors, Messrs. Marvin H. Fink and Ellsworth Roston and Dr. Robert Koblin, as compensation for serving on the compensation committee of our board of directors, options to purchase 5,000, 5,000 and 5,000 common shares at $5.05 per share. The options vest quarterly over a period of one year, and lapse if unexercised on February 3, 2010. We valued each grant at $11,331 for pro-forma financial statement purposes using the Black-Scholes model.

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On January 3 2005, we issued to two directors, Ms. Jennifer Black and Mr. Ellsworth Roston, as compensation for serving on the audit committee of our board of directors, options to purchase 10,000 and 10,000 common shares at $5.05 per share. The options vest quarterly over a period of one year, and lapse if unexercised on February 3, 2010. We valued each grant at $22,661 for pro-forma financial statement purposes using the Black-Scholes model.

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On January 20 2005, we issued to one director, Ms. Jennifer Black, as compensation for serving on our board of directors, options to purchase 28,000 common shares at $3.95 per share. The options vest quarterly over a period of one year, and lapse if unexercised on January 19, 2010. We valued the grant at $48,285 for pro-forma financial statement purposes using the Black-Scholes model.

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On March 31, 2005, we closed a private placement wherein we sold a total of 1,562,500 unregistered common shares, together with common share purchase warrants entitling the holder to purchase 1,500,000 restricted common shares, to Trellus Partners, LP for the sum of $5,000,000. The warrants are exercisable at $1.60 per share, contain cashless exercise provisions, and lapse if unexercised on or before March 31, 2010.

Rule 505

During the three-month interim period ended March 31, 2005, we sold or issued the following securities not registered under the Securities Act of 1933 by reason of the exemption afforded under SEC Rule 505 of Regulation D promulgated under Section 3(b) of the Securities Act. The offer and sale of the securities in each offering was exempt from the registration requirements of the Securities Act under Rule 505 insofar as: (1) except as stated below, none of the investors in the offering are to the company s knowledge accredited within the meaning of Rule 501(a); (2) pursuant to Rule 505(b)(2)(i), the aggregate offering price for the offering did not exceed $5,000,000, less the offering price of all securities sold within the twelve months preceding the start of and during the offering of securities under Rule 505 or in reliance upon any exemption under Section 3(b) of the Securities Act of 1933 or in violation of Section 5 of the Securities Act of 1933; (3) pursuant to Rule 505(b)(2)(ii), there were no more than 35 non-accredited investors in the offering; (4) no offers or sales under the offering was effected through any general solicitation or general advertising within the meaning of Rule 502(c); and (5) the transfer of the securities in the offering were restricted by the company in accordance with Rule 502(d). Except as stated below, no underwriting discounts or commissions were payable with respect to any of the offerings.

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On February 1, 2005, we issued to seven employees options to purchase a total of 92,000 common shares at $4.05 per share. The options vest over a period of five years, and lapse if unexercised on January 31, 2010. We valued the grant at $183,686 for pro-forma financial statement purposes using the Black-Scholes model.

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On March 22 2005, we issued to one director, Ms. Lucy Duncan-Scheman, as compensation for serving on our board of directors, options to purchase 50,000 common shares at $3.10 per share. The options vest quarterly over a period of one year, and lapse if unexercised on March 21, 2010. We valued the grant at $76,413 for pro-forma financial statement purposes using the Black-Scholes model.

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Use Of Proceeds Of Registered Offerings

Not Applicable.

Repurchases Of Equity Securities

During the three-month interim period ended March 31, 2005, we did not repurchase any equity securities.

DEFAULTS UPON SENIOR SECURITIES

Not Applicable.

SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not Applicable.

CONTROLS AND PROCEDURES

Evaluation Of Disclosure Controls And Procedures

Disclosure controls and procedures are designed to ensure that information required to be disclosed in the quarterly reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time period specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports filed under the Exchange Act is accumulated and communicated to management, including our President and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Our Chief Executive Officer and Chief Financial Officer, in consultation with our other members of management and advisors as appropriate, carried out an evaluation of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report pursuant to Rule 15d-15(b) promulgated under the Exchange Act. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective in alerting them in a timely fashion to all material information required to be included in our periodic filings with the SEC.

Changes in Internal Control over Financial Reporting

The term i*nternal control over financial reporting* is defined as a process designed by, or under the supervision of, our President and Principal Financial Officer, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. There were no changes in our internal control over financial reporting identified in connection with our evaluation of these controls as of the end of the period covered by this quarterly report that could have significantly affected those controls subsequent to the date of the evaluation referred to in the previous paragraph, including any correction action with regard to significant deficiencies and material weakness.

Changes in Internal Controls To Correct Previously Reported Significant Deficiencies

As previously reported on our form 10-KSB for our year ended December 31, 2004, in connection with the audit of our financial statements for our year ended December 31, 2004 our independent auditors identified that our accounting for the beneficial conversion feature of a convertible promissory note issued on December 28, 2004, which feature we had originally recognized and amortized commencing February 14, 2005 based upon management s interpretation of the application of existing accounting principles to the underlying contract

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documents, should have instead been recognized and amortized commencing December 28, 2004. Our independent auditors discussed this matter with our Chief Financial Officer and other members of management, and we subsequently reevaluated the transaction and recorded an adjustment. The auditors believe that this adjustment reflected a significant deficiency in our internal controls over the application of existing accounting principles to new transactions and financial reporting. This deficiency would have resulted in a material misstatement to the financial statements for the year ended December 31, 2004. To remediate this deficiency, we took corrective action during the three-month interim period ended March 31, 2005 to enhance our internal controls as they relate to addressing complex accounting issues by resolving to forward our proposed treatment of these complex accounting issues to outside professionals (other than our independent auditors) for review in situations where the accounting treatment is unclear or extremely complex.

Observations

In connection with the audit of Recom s financial statements for the year ended December 31, 2004, our independent auditors made several observations relating to our disclosure controls and procedures or internal controls. First, our independent auditors observed that Recom did not have adequate segregation of duties due to the size of the company, and that management had the ability to override any existing controls. Management acknowledges the existence of this problem, and is developing procedures to address them to the extent possible given the acknowledged limitations. Secondly, our independent auditors observed that Recom did not have a comprehensive accounting procedures manual including information as to customized internal control structure, documentation and transaction flow. Our management acknowledges the existence of this problem, and is developing procedures to address them to the extent possible given limitations in financial and manpower resources. Finally, our independent auditors observed that none of the members of our audit committee demonstrated an in-depth understanding of generally accepted accounting principles. We acknowledge that while we believe our audit committee members are proficient in reading and understanding financial statements, they may not have an in-depth understanding of generally accepted accounting principles, and we are currently evaluating whether we should seek a person with a professional accounting background to join the board and to serve on the audit committee.

OTHER INFORMATION

Voluntary Reports

None.

Material Changes To Director Nominee Procedures

There have been no material changes to the procedures by which our shareholders may recommend nominees to our board of directors since our last disclosure of those procedures pursuant to SEC rules.

EXHIBITS AND REPORTS ON FORM 8-K

Exhibits

2.1

Order dated October 26, 2000 Confirming Plan of Reorganization and Granting Final Approval of Disclosure Statement (9)

3.1

Amended And Restated Certificate Of Incorporation Of Recom Managed System, Inc. filed by the Delaware Secretary of State on November 6, 2000 (1)

3.2

Certificate Of Amendment Of Certificate Of Incorporation Of Recom Managed System, Inc. filed by the Delaware Secretary of State on June 20, 2003 (8)

3.3

Certificate Of Designation Of Rights, Preferences And Limitations Of Series A Convertible Preferred Stock Of Recom Managed System, Inc. filed by the Delaware Secretary of State on September 9, 2003 (9)

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3.4

Amendment To Certificate Of Designation Of Rights, Preferences And Limitations Of Series A Convertible Preferred Stock Of Recom Managed System, Inc. filed by the Delaware Secretary of State on April 26, 2004 (9)

3.5

Bylaws Of Recom Managed Systems, Inc. adopted March 31, 2003 (6)

5.1

Specimen common stock certificate (8)

5.2

Specimen series A preferred stock certificate (8)

5.3

Recom Managed Systems, Inc. 2002 Stock Plan adopted on November 1, 2002 (6)

5.4

Form of option issued under Recom Managed Systems, Inc. 2002 Stock (8)

5.5

Recom Managed Systems, Inc. 2003 Nonqualified Stock Option And Stock Plan adopted on March 31, 2002 (6)

5.6

Warrant To Purchase Common Stock dated September 19, 2002 issued to Sim Farrar (2)

5.7

Form of Standard Warrant (8)

5.8

Form of Class A Warrant (8)

5.9

Form of Class C Warrant (8)

5.10

Agent s Warrant dated November 1, 2003 with Maxim Group LLC (9)

5.11

Agent s Warrant dated November 1, 2003 with Jenkins Capital Management, LLC (11)

5.12

Common Stock Purchase Warrant dated December 29, 2004 granted to DKR SoundShore Oasis Holding Fund Ltd. (13)

5.13

Common Stock Purchase Warrant dated March 31, 2005 granted to Trellus Partners, LP *

5.14

Common Stock Purchase Warrant dated April 8, 2005 granted to Lagunitas Partners, LP *

5.15

Common Stock Purchase Warrant dated April 8, 2005 granted to Gruber & McBaine International *

5.16

Common Stock Purchase Warrant dated April 8, 2005 granted to John D and Linda W. Gruber *

5.17

Common Stock Purchase Warrant dated April 8, 2005 granted to J. Patterson McBaine *

10.1

Standard Multi-Tenant Office Lease dated August 20, 2002 between Bershin Properties I, LLC, as lessor, and Recom Managed Systems, Inc., LLC, as lessee (9)

10.2

Addendum To Standard Office Lease dated August 20, 2002 between Bershin Properties I, LLC, as lessor, and Recom Managed Systems, Inc., as lessee (9)

10.3

Addendum To Standard Office Lease dated December 17, 2003 between Bershin Properties I, LLC, as lessor, and Recom Managed Systems, Inc., as lessee (9)

10.4

Stock Acquisition and Signal Technologies Transfer Agreement dated September 12, 2002 between Recom Managed Systems, Inc. and ARC Finance Group, LLC (2)

10.5

Employment Agreement dated October 14, 2002 between Recom Managed Systems, Inc. and Marvin H. Fink (3)

10.6

License Agreement dated December 9, 1993 between Dr. Budimir S. Drakulic and Teledyne Electronic Industries, Inc. (8)

10.7

Restricted Stock Agreement dated October 14, 2002 between Recom Managed Systems, Inc. and Marvin H. Fink (3)(4)

10.8

Indemnification Agreement dated October 14, 2002 between Recom Managed Systems, Inc. and Marvin H. Fink (3)(4)

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10.9

Loan-out Agreement dated October 15, 2002 between Recom Managed Systems, Inc. and Budimir Drakulic, B World and B Technologies (3)

10.10

Restricted Stock Agreement dated October 15, 2002 between Recom Managed Systems, Inc. and Budimir Drakulic, B World and B Technologies (3)(5)

10.11

Consulting Agreement dated November 1, 2002 between Recom Managed Systems, Inc. and Ellsworth Roston (3)

10.12

Employment, Confidential Information, Invention Assignment, And Arbitration Agreement dated October 15, 2002 between Recom Managed Systems, Inc. and Budimir Drakulic, B World and B Technologies (3)(5)

10.13

Consulting Agreement dated February 14, 2003 between Recom Managed Systems, Inc. and Lowell T. Harmison (8)

10.14

Employment Agreement dated March 10, 2003 between Recom Managed Systems, Inc. and Charles E. McGill (6)

10.15

Investment Banking Agreement dated April 15, 2003 between Recom Managed Systems, Inc. and Brookstreet Securities Corporation (7)

10.16

Investment Banking Agreement dated July 17, 2003 between Recom Managed Systems, Inc. and Maxim Group, LLC (9)

10.17

Placement Agency Agreement dated September 4, 2003 between Recom Managed Systems, Inc. and Maxim Group, LLC (9)

10.18

Form of Registration Rights Agreement for purchasers of Series A Preferred Stock (8)

10.19

Scope Letters and Engagement Agreements dated December 18, 2003, January 23, 2004 and March 22, 2004 between Recom Managed Systems, Inc. and CFO 911 (9)

10.20

Non-Binding Letter of Intent dated January 10, 2004 between Recom Managed Systems, Inc. and TZ Medical Inc. (9)

10.21

Settlement Agreement And Releases, Warrant and Piggyback Registration Rights Agreement each dated April 28, 2004 between Recom Managed Systems, Inc., Mitchell J. Stein, ARC Finance Group, LLC, Tracey Hampton-Stein and Rex Julian Beaber (9)

10.22

Consulting Agreement between Recom Managed Systems, Inc. and Dr. Michael Laks (10)

10.23

Consulting Agreement between Recom Managed Systems, Inc. and Dr. Mitchell W. Krucoff (10)

10.24

Research And Development Services Agreement dated May 12, 2004 between Recom Managed Systems, Inc. and Battelle Memorial Institute (10)

10.25

Consulting Agreement between Recom Managed Systems, Inc. and Dr. Andrea Natale (11)

10.26

Sponsored Research Agreement dated August 30, 2004 between Recom Managed Systems, Inc. and Duke Clinical Research Institute (12)

10.27

Securities Purchase Agreement dated December 29, 2004 between Recom Managed Systems, Inc. and DKR SoundShore Oasis Holding Fund Ltd. (13)

10.28

8% Convertible Debenture dated December 29, 2004 granted to DKR SoundShore Oasis Holding Fund Ltd. (13)

10.29

Registration Rights Agreement dated December 29, 2004 between Recom Managed Systems, Inc. and DKR SoundShore Oasis Holding Fund Ltd. (13)

10.30

Common Stock Purchase Agreement dated March 31, 2005 between Recom Managed Systems, Inc. and Trellus Partners, LP *

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10.31

Registration Rights Agreement dated March 31, 2005 between Recom Managed Systems, Inc. and Trellus Partners, LP *

10.32

Common Stock Purchase Agreement dated April 8, 2005 between Recom Managed Systems, Inc. and Lagunitas Partners, LP, Gruber & McBaine International, Jon D. and Linda W. Gruber, and J. Patterson McBaine, LP *

10.33

Registration Rights Agreement dated April 8, 2005 between Recom Managed Systems, Inc. and Lagunitas Partners, LP, Gruber & McBaine International, Jon D. and Linda W. Gruber, and J. Patterson McBaine, LP *

10.34

Employment Agreement dated April 15, 2005 between Recom Managed Systems, Inc. and Pamela Bunes *

10.35

Employment Agreement dated April 15, 2005 between Recom Managed Systems, Inc. and Rodney Hildebrandt *

21.

List of subsidiaries (15)

*

Filed herewith

(1)

Previously filed as an exhibit to our annual report on form 10-KSB for our fiscal year ended December 31, 2001 filed with the SEC on February 22, 2002.

(2)

Previously filed as an exhibit to our current report on form 8-K filed with the SEC on September 25, 2002.

(3)

Previously filed as an exhibit to our quarterly report on form 10-QSB for our fiscal quarter ended September 30, 2002 filed with the SEC on November 12, 2002.

(4)

Filed as part of the Employment Agreement for Mr. Fink noted in item 10.5.

(5)

Filed as part of the Loan-Out Agreement for with B World Technologies, B Technologies and Dr. Drakulic noted in item 10.9.

(6)

Previously filed as an exhibit to our annual report on form 10-KSB for our fiscal year ended December 31, 2002 filed with the SEC on March 26, 2003.

(7)

Previously filed as an exhibit to our quarterly report on form 10-QSB for our fiscal quarter ended March 30, 2003 filed with the SEC on May 7, 2003.

(8)

Previously filed as an exhibit to our registration statement on form SB-2 filed with the SEC on January 2, 2004.

(9)

Previously filed as an exhibit to our registration statement on form SB-2 (amendment no. 2) filed with the SEC on May 11, 2004.

(10)

Previously filed as an exhibit to our registration statement on form SB-2 (amendment no. 3) filed with the SEC on July 26, 2004.

(11)

Previously filed as an exhibit to our registration statement on form SB-2 (amendment no. 4) filed with the SEC on October 18, 2004.

(12)

Previously filed as an exhibit to our registration statement on form SB-2 (amendment no. 5) filed with the SEC on November 5, 2004.

(13)

Previously filed as an exhibit to our current report on form 8-K filed with the SEC on December 30, 2004.

(14)

Previously filed as an exhibit to our registration statement on form SB-2 filed with the SEC on January 26, 2005.

(15)

Previously filed as an exhibit to our annual report on form 10-KSB for our fiscal year ended December 31, 2004 filed with the SEC on March 31, 2005.

Reports on Form 8-K

During the three-month interim period ended March 31, 2005, we filed the following current reports on form 8-K:

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On March 29, 2005, we filed a current report on form 8-K relating to (1) our entering into a Research and Development Services Agreement with Battelle Memorial Institute to design, fabricate and test a pre-production model of our Model 200 Patient Module; and (2) changes in our management including the resignations of Mr. Marvin H. Fink and Dr. Robert G. Koblin from our board of directors and the appointments of Ms. Lucy Duncan-Scheman and Pamela Bunes and Mr. Rodney Hildebrandt to our board of directors, and the replacement of Mr. Marvin H. Fink as our Chief Executive Officer.

SIGNATURES

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

Dated at Studio City, California, this 16th day of May, 2005.

RECOM MANAGED SYSTEMS, INC.

By: */s/ Pamela Bunes*

Pamela Bunes
Chief Executive Officer and President
(principal executive officer)

By: */s/ Robert C. Scherne*

Robert C. Scherne
Interim Chief Financial Officer
(principal accounting and financial officer)

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7.3
%
Income from operations

$
8,444

$
9,147

$
16,147

$
15,456

Percentage of net sales

4.2
%

4.6
%

4.2
%

3.8
%
Net income

$
5,039

$
6,324

$
9,861

$
11,258

Percentage of net sales

2.5
%

3.2
%

2.6
%

2.8

%
Diluted income per share

$
0.18

$
0.23

$
0.36

$
0.41

Net Sales

As noted above, net sales in the second quarter of 2014 were unchanged when compared to the second quarter of 2013, totaling $199.0 million for both periods. Wheel sales in the second quarter of 2014 increased $0.8 million to $196.6 million from $195.8 million in 2013 as wheel shipments increased 1 percent in the 2014 period. Unit shipments increased to Ford, Nissan, GM, Subaru, VW and Tesla, while shipments to Chrysler, Toyota and BMW decreased. Shipments to other customers were minimal and remained relatively unchanged. The average selling price of our wheels decreased slightly primarily reflecting the decline in the value of the aluminum component of sales which we generally pass through to our customers. The decline in aluminum value resulted in $2.1 million lower revenues in the second quarter of 2014 when compared to 2013. Wheel development revenues totaled $2.3 million in the second quarter of 2014 and $3.2 million in the comparable 2013 period.

Net sales in the first half of 2014 decreased $23.0 million, or 6 percent, to $382.4 million from $405.4 million in the comparable period a year ago. Wheel sales in the first half of 2014 decreased $22.2 million to $377.9 million from $400.1 million in 2013. The decline in wheel sales primarily resulted from 4 percent lower unit shipments in the first half of 2014 compared to the first half of 2013. The average selling price of our wheels decreased 2 percent primarily reflecting the decline in the value of the aluminum component of sales which we generally pass through to our customers. The decline in aluminum value resulted in $9.1 million lower revenues in the first half of 2014 when compared to 2013. Wheel development revenues totaled $4.5 million in the first half of 2014 and $5.3 million in the comparable 2013 period.

U.S. Operations
Net sales of our U.S. wheel plants in the second quarter of 2014 decreased $3.7 million, or 5 percent, to $73.6 million from $77.3 million in the comparable period a year ago reflecting a decrease in unit shipments, partially offset by an increase in average selling prices. Wheel sales in the second quarter of 2014 decreased $3.0 million, or 4 percent, to $71.4 million from $74.4 million in the second quarter last year, with a $5.9 million revenue decline attributable to a 8 percent decrease in unit shipments. The average unit selling price increased 4 percent due to a favorable mix of wheel sizes and finishes sold, which was partially offset by a decrease in the pass-through price of aluminum. The decline in aluminum value reduced revenues by approximately $0.8 million in 2014 when compared to 2013.

During the first half of 2014, net sales of our U.S. wheel plants decreased $16.0 million, or 10 percent, to $138.1 million from $154.1 million in the comparable period a year ago reflecting a decrease in unit shipments, partially offset by an increase in average selling prices. Wheel sales in the first half of 2014 decreased $15.4 million, or 10 percent, to $133.9 million from $149.3 million

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in the first half last year. A 14 percent decrease in unit shipments caused a $20.3 million decline in revenue. The average unit selling price increased 3 percent due to a favorable mix of wheel sizes and finishes sold, which was partially offset by a decrease in the pass-through price of aluminum. The decline in aluminum value reduced revenues by approximately $3.1 million in 2014 when compared to 2013.

Mexico Operations
Net sales of our Mexico operations in the second quarter of 2014 increased $3.7 million, or 3 percent, to $125.4 million from $121.7 million in the comparable period a year ago, reflecting an increase in unit shipments partially offset by a decrease in average selling prices of our wheels. Unit shipments increased 7 percent in the second quarter of 2014, with the higher volume resulting in an $8.0 million revenue increase. The average unit selling price decreased 3 percent partially due to a decline in the value of the aluminum component of sales, which we generally pass through to our customers and an unfavorable change in the mix of wheel sizes and finishes sold. The decline in aluminum value reduced revenues by approximately $1.4 million in the second quarter of 2014 when compared to the second quarter of 2013.

During the first half of 2014, net sales of our Mexico operations decreased $7.0 million, or 3 percent, to $244.3 million from $251.3 million in the comparable period a year ago, reflecting a decrease in average selling prices of our wheels partially offset by an increase in unit shipments. The average unit selling price decreased 5 percent due to a decline in the value of the aluminum component of sales, which we generally pass through to our customers and an unfavorable change in the mix of wheel sizes and finishes sold. The decline in aluminum value reduced revenues by approximately $6.0 million in the first half of 2014 when compared to the first half of 2013. Unit shipments increased 3 percent in the first half of 2014, with the higher volume resulting in a $6.6 million revenue increase.

Customer Comparisons
As reported by industry publications, North American production of passenger cars and light trucks in the second quarter of 2014 was up approximately 4 percent compared to the same quarter in the previous year, while our unit wheel shipments increased 1 percent for the comparable period. The overall increase in North American light vehicle production included a 10 percent increase in the light-duty truck category and a 4 percent decline for passenger cars. Comparing the same time periods for Superior, our shipments of passenger car wheels increased 2 percent and light-duty truck wheels increased 1 percent.

OEM unit shipment composition by customer was as follows:

	Thirteen Weeks Ended	
	June 29, 2014	June 30, 2013
Ford	43%	41%
General Motors	24%	23%
Toyota	11%	13%
Chrysler	10%	12%
International customers (excluding Toyota)	12%	11%
Total	100%	100%

At the customer level, unit shipments to Ford in the second quarter of 2014 increased 5 percent compared to the second quarter last year, as light-duty truck wheels increased 7 percent and passenger car wheel shipments decreased 5 percent. At the program level, the major unit shipment increases were for the F-Series Truck, Explorer, Expedition and the Lincoln MKC, partially offset by unit shipment decreases for the Edge, Fiesta and Escape.

Shipments to GM in the second quarter of 2014 increased 4 percent compared to the second quarter of 2013, as passenger car wheel shipments increased 33 percent and light-duty truck wheel shipments increased 2 percent. The major unit shipment increases to GM were for the Chevrolet Volt, Cadillac SRX and the K2XX platform vehicles, partially offset by unit shipment decreases for the Buick LaCrosse.

Shipments to Toyota in the second quarter of 2014 decreased 12 percent compared to the second quarter last year, as shipments of passenger car wheels decreased 26 percent and light-duty truck wheels decreased 2 percent. The major unit shipment decreases to Toyota were for the Avalon, Venza and Sienna, partially offset by unit shipment increases for the Highlander and Tundra.

Shipments to Chrysler in the second quarter of 2014 declined 14 percent compared to the second quarter last year, as shipments of both light-duty truck wheels and passenger car wheels decreased 14 percent. The major unit shipment decreases to Chrysler

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were for the Dodge Journey and Caravan, and the Jeep Compass, which were partially offset by unit shipment increases for the Chrysler Town & Country and Dodge Durango.

Shipments to international customers (excluding Toyota) in the second quarter of 2014 increased 11 percent compared to the second quarter of 2013, as shipments of passenger car wheels increased 23 percent and shipments of light-duty truck wheels decreased 16 percent. At the program level, major unit shipment increases to international customers were for Nissan's Note and Maxima, and Subaru's Outback, partially offset by unit shipment decreases for the Nissan Altima and BMW X3.

Cost of Sales
Aluminum, natural gas and other direct material costs are a significant component of our costs to manufacture wheels. These components of our costs of sales are substantially the same for all of our plants since many common suppliers service both our U.S. and Mexico operations. Consolidated cost of sales includes costs for both our U.S. and international operations and certain costs that are not allocated to a specific operation. These unallocated expenses include corporate services that are primarily incurred in the U.S. but are not charged directly to our world-wide operations, such as engineering services for wheel program development and manufacturing support, environmental and other governmental compliance services.

Consolidated cost of goods sold decreased $0.4 million to $183.2 million in the second quarter of 2014, or 92 percent of net sales, compared to $182.8 million, or 92 percent of net sales, in the second quarter of 2013. Cost of sales in 2014 primarily reflects a decrease in aluminum prices, which we generally pass through to our customer partially offset by a 1 percent increase in unit shipments. Direct material and subcontract costs decreased approximately $1.6 million to $108.4 million from $110.0 million in the second quarter of 2013. The change in direct material costs includes a reduction of approximately $2.4 million due to aluminum price decreases, which we generally pass through to our customers. Supply and small tool costs decreased $0.1 million to $6.7 million and repair and maintenance costs increased $0.3 million to $7.0 million in the second quarter of 2014 when compared to the second quarter of 2013. Plant labor and benefit costs were $31.2 million in the second quarter of 2014, a decrease of $1.6 million compared to the second quarter last year. Cost of sales associated with corporate services such as engineering support for wheel program development and manufacturing support increased $0.1 million in the second quarter of 2014 when compared to the 2013 period.

For the first half of 2014 our consolidated cost of goods sold decreased $24.7 million to $351.0 million in the first half of 2014, or 92 percent of net sales, compared to $375.7 million, or 93 percent of net sales, in the first half of 2013. Cost of sales in 2014 primarily reflects a 4 percent decrease in unit shipments and a decrease in aluminum prices, which we generally pass through to our customers. Direct material and subcontract costs decreased approximately $20.2 million to $205.6 million from $225.8 million in the first half of 2013. The change in direct material costs includes a reduction of approximately $11.2 million due to aluminum price decreases, which we generally pass through to our customers. Compared to the first half of 2013, supply and small tool costs decreased $2.4 million to $12.2 million and repair and maintenance costs decreased $0.6 million to $13.7 million, in the first half of 2014. Plant labor and benefit costs were $60.7 million in the first half of 2014, a decrease of $6.6 million compared to the first half last year. Cost of sales associated with corporate services such as engineering support for wheel program development and manufacturing support decreased $0.8 million in the first half of 2014 when compared to the 2013 period. The improvements were reflective of several items including reduction of headcount in reaction to the unit volume decline, as well as the benefits to manufacturing productivity from capital improvements and increased equipment reliability. The lower production levels, however, had an unfavorable impact on cost of sales from lower absorption of fixed overhead costs in the first half of 2014, when compared to last year.

Included below are the major items that impacted cost of sales for our U.S. and Mexico operations during the second quarter and first half of 2014.

U.S. Operations

Cost of sales for our U.S. operations decreased by $3.3 million, or 4 percent, in the second quarter of 2014 as compared to the second quarter of 2013. Compared to the prior year, lower cost of sales for our U.S. wheel plants in the 2014 period primarily reflects an 8 percent decrease in unit shipments, a decrease in labor costs and a $1.0 million decline in aluminum prices, which we generally pass on to our customers. When compared to the prior year, the second quarter 2014 decline in plant labor and benefit costs was approximately $2.8 million, or 15 percent, primarily as a result of decreases in headcount and contract labor costs. Additionally, wheels produced per labor hour increased 19 percent while labor cost per wheel decreased 4 percent when compared to the second quarter of 2013. Cost of sales in the 2014 period also include an increase in plant repair and maintenance costs of $0.3 million, while supply and small tool costs were flat when compared to the second quarter of 2013. Overall, costs for the period declined, however, lower production levels had an unfavorable impact on cost of sales from lower absorption of fixed overhead costs in the second quarter of 2014, when compared to last year.

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For the first half of 2014, cost of sales for our U.S. operations decreased by $15.6 million, or 10 percent, when compared to the first half of 2013. Lower cost of sales for our U.S. wheel plants in the 2014 period primarily reflects a 14 percent decrease in unit shipments, decreases in labor and other costs, as well as a $3.5 million decline in aluminum prices, which we generally pass on to our customers. When compared to the prior year, the first half of 2014 decline in plant labor and benefit costs was approximately $8.2 million, or 20 percent, primarily as a result of decreases in headcount, contract labor and overtime. Additionally, wheels produced per labor hour increased 12 percent while labor cost per wheel decreased 1 percent when compared to the first half of 2013. Lower cost of sales in the 2014 period also resulted from decreases in supply and small tool costs of $2.1 million and plant repair and maintenance costs of $0.6 million. The improvements were reflective of several items including reduction of headcount in reaction to the unit volume decline, as well as the benefits to manufacturing productivity from capital improvements and increased equipment reliability. The lower production levels, however, had an unfavorable impact on cost of sales from lower absorption of fixed overhead costs in the first half of 2014, when compared to last year.

Mexico Operations

Cost of sales for our Mexico operations in the second quarter of 2014 increased by $3.7 million, or 4 percent, when compared to the second quarter of 2013. The 2014 increase primarily reflects a 7 percent increase in unit shipments and increased labor costs, partially offset by an approximate $1.5 million decrease in aluminum prices, which we generally pass through to our customers. During the second quarter of 2014, plant labor and benefit costs increased approximately $1.2 million, or 9 percent, when compared to the second quarter last year. During the second quarter of 2014, wheels produced per labor hour increased 1 percent while labor cost per wheel increased 8 percent when compared to the second quarter of 2013.

For the first half of 2014, cost of sales for our Mexico operations in the first half of 2014 decreased by $8.3 million, or 4 percent, when compared to the first half of 2013. Despite a 3 percent increase in unit shipments, the 2014 cost of sales decrease primarily reflects an approximate $8.0 million decrease in aluminum prices, which we generally pass through to our customers, a mix of wheels with lower production costs and improved absorption of fixed overhead costs, when compared to last year. During the first half of 2014, plant labor and benefit costs increased approximately $1.6 million, or 6 percent, when compared to the first half last year. During the first half of 2014, wheels produced per labor hour increased 3 percent while labor cost per wheel increased 4 percent when compared to the first half of 2013.

Gross Profit

Consolidated gross profit decreased $0.5 million for the second quarter of 2014 to $15.7 million, or 8 percent of net sales, compared to $16.2 million, or 8 percent of net sales, for the comparable period a year ago. The decrease in gross profit reflects a variety of items, including unreimbursed cost increases for aluminum alloying premiums and an increase in unreimbursed development costs of $0.9 million, which offset the benefit from the 1 percent increase in unit shipments in the second quarter of 2014 when compared to the comparable period last year. For the first half of 2014, consolidated gross profit increased $1.6 million to $31.4 million, or 8 percent of net sales, compared to $29.8 million, or 7 percent of net sales, for the comparable period a year ago. Unit shipments decreased 4 percent in the first half of 2014, when compared to the comparable period last year. The improvement in gross profit in the first half of 2014 primarily reflects overall improvements in costs and favorable timing of aluminum pricing adjustments as explained below, which offset the impact of the decline in volume.

The cost of aluminum is a component of our selling prices to OEM customers and a significant component of the overall cost of a wheel. The price for aluminum we purchase is adjusted monthly based primarily on changes in certain published market indices. Our selling prices are adjusted periodically based upon aluminum market price changes, but the timing of such adjustments is based on specific customer agreements and can vary from monthly to quarterly. Even if aluminum selling price adjustments were to perfectly match changes in aluminum purchase prices, an increasing aluminum price will result in a declining gross margin percentage - i.e., same gross profit dollars divided by increased sales dollars equals lower gross profit percentage. The opposite is true in periods during which the price of aluminum decreases. In addition, although our sales are continuously adjusted for aluminum price changes, these adjustments rarely will match exactly the changes in our aluminum purchase prices and cost of sales. As estimated by the company, the favorable impact on gross profit related to such differences in timing of aluminum adjustments was approximately $0.3 million in the second quarter of 2014 and $2.1 million for the first half of 2014, when compared to the comparable periods in 2013.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the second quarter of 2014 increased $0.2 million to $7.3 million, or 4 percent of net sales, from $7.1 million, or 4 percent of net sales, for the comparable period in 2013. The 2014 period cost increase is primarily attributable to higher other professional service fees of $0.4 million, legal fees of $0.3 million and stock-based compensation expenses of $0.3 million, while the 2013 period included a $0.4 million expense related to a Mexico customs audit settlement. For the first half of 2014, selling, general and administrative expenses were $15.2 million, or 4 percent of net sales,

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compared to $14.3 million, or 4 percent of net sales for the comparable period last year. The 2014 period cost increase is primarily attributable to a $1.0 million increase in executive severance costs and $0.8 million higher other professional service fees, somewhat offset by lower audit fees of $0.3 million, and, as noted above, a $0.4 million expense related to a customs audit settlement in 2013.

Income from Operations

As described in the discussion of cost of sales above, aluminum, natural gas and other direct material costs are substantially the same for all our plants since many common suppliers service both our U.S. and Mexico operations. In addition, our operations in the U.S. and Mexico sell to the same customers, utilize the same marketing and engineering resources, have interchangeable manufacturing processes and provide the same basic end product. However, profitability between our U.S. and Mexico operations can vary as a result of differing labor and benefit costs, the specific mix of wheels manufactured and sold by each plant, as well as differing plant utilization levels resulting from our internal allocation of wheel programs to our plants.

Consolidated income from operations includes our U.S. and international operations and certain costs that are not allocated to a specific operation. These unallocated expenses include corporate services that are primarily incurred in the U.S. but are not charged directly to our operations, such as selling, general and administrative expenses, engineering services for wheel program development and manufacturing support, environmental and other governmental compliance services.

Consolidated income from operations decreased $0.7 million in the second quarter of 2014 to $8.4 million, or 4 percent of net sales, from $9.1 million, or 5 percent of net sales, in the comparable period in 2013. Income from our Mexican operations increased $0.7 million in the second quarter of 2014. For the second quarter of 2014 income from our U.S. operations increased $0.5 million when compared to the second quarter of 2013. Unallocated corporate costs incurred during the second quarter of 2014 were $1.9 million higher than the comparable period in 2013 and included increases in unreimbursed development costs of $0.9 million, consulting fees of $0.4 million, legal fees of $0.3 million and $0.2 million of stock-based compensation expenses.

Consolidated income from operations increased $0.6 million to $16.1 million, or 4 percent of net sales, in the first half of 2014 from $15.5 million, or 4 percent of net sales, in the comparable period in 2013. Income from our Mexican operations increased $2.5 million in the first half of 2014. Income from our U.S. operations increased $0.4 million when comparing the first half of 2014 to the comparable period in 2013. Unallocated corporate costs incurred during the first half of 2014 were $2.2 million higher than the comparable period in 2013 including increases in executive severance costs of $1.0 million, consulting fees of $0.8 million and unreimbursed development costs of $0.6 million.

Included below are the major items that impacted income from operations for our U.S. and Mexico operations during 2014.

U.S. Operations

Operating income from our U.S. operations in the second quarter of 2014 increased $0.5 million when compared to the second quarter last year. Operating income increased in the second quarter of 2014 as improvements in average selling prices of our wheels and lower costs overall offset the impact of an 8 percent decrease in unit shipments. The average selling price of our wheels increased due to an improved mix of wheel sizes and finishes sold, and the overall cost improvement was primarily driven by lower labor costs. While costs improved overall, the lower production levels had an unfavorable impact on operating income due to lower absorption of fixed overhead costs in the second quarter of 2014, when compared to last year. As a percentage of net sales, our gross margin increased slightly in the second quarter of 2014 when compared to the same period of 2013.

For the first half of 2014, income from our U.S. operations increased $0.4 million when compared to the first half last year. Operating income increased in the first half of 2014 as improvements in average selling prices of our wheels and lower costs overall offset the impact of a 14 percent decrease in unit shipments. The average selling price of our wheels increased due to an improved mix of wheel sizes and finishes sold, and the overall cost improvement included reductions in labor, repair, maintenance and supply costs. While costs improved overall, the lower production levels had an unfavorable impact on operating income due to lower absorption of fixed overhead costs in the first half of 2014, when compared to last year. As a percentage of net sales, our gross margin was flat in the first half of 2014 when compared to the same period of 2013.

Mexico Operations

Income from our Mexico operations increased $0.7 million in the second quarter of 2014 as compared to the second quarter of 2013. As a percentage of net sales, our gross margin was flat when comparing the second quarter of 2014 with the second quarter of 2013. Income from operations increased as a result of a 7 percent increase in unit shipments partially offset by lower average selling prices of our wheels and higher manufacturing costs.

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For the first half of 2014, income from our Mexico operations increased $2.5 million when compared to the first half of 2013. Income from operations in 2014 reflects an increase in gross profit of $1.3 million. As a percentage of net sales, our gross margin improved 1 percentage point when comparing the first half of 2014 with the first half of 2013. Income from operations increased as a result of a 3 percent increase in unit shipments and favorable aluminum price adjustments partially offset by lower average selling prices of our wheels and higher manufacturing costs.

U.S. versus Mexico Production

During the second quarter of 2014, wheels produced by our Mexico and U.S. operations accounted for 67 percent and 33 percent, respectively, of our total production. For the first half of 2014, wheels produced by our Mexico and U.S. operations accounted for 68 percent and 32 percent, respectively, of our total production. We currently anticipate that the percentage of production in Mexico will increase to between 65 percent and 70 percent of our total production for the remainder of 2014.

Interest Income, net and Other Income (Expense), net

Net interest income decreased $0.1 million in the second quarter of 2014 when compared to the second quarter of 2013, and decreased $0.2 million in the first half of 2014 when compared to the first half of 2013.

Net other income (expense) was expense of $0.1 million in the second quarter of 2014, compared to income of $0.3 million in the second quarter of 2013. Foreign exchange gains and (losses) included in other income (expense) net were exchange losses of $0.2 million in the second quarter of 2014, compared to exchange gains of $0.3 million in the second quarter of 2013. For the first half of 2014, net other income (expense) was expense of $0.1 million, compared to income of $0.4 million in the first half of 2013. Foreign exchange gains and (losses) included in other income (expense) net were exchange losses of $0.2 million in the first half of 2014, compared to exchange gains of $0.4 million in the first half of 2013.

Income Taxes

We account for income taxes using the asset and liability method. The asset and liability method requires the recognition of deferred tax assets and liabilities for expected future tax consequences of temporary differences that currently exist between the tax basis and financial reporting basis of our assets and liabilities. We calculate current and deferred tax provisions based on estimates and assumptions that could differ from actual results reflected on the income tax returns filed during the following years. Adjustments based on filed returns are recorded when identified in the subsequent years.

The effect on deferred taxes of a change in tax rates is recognized in income in the period that the tax rate change is enacted. In assessing the likelihood of realization of deferred tax assets, we consider whether it is more likely than not that some portion of the deferred tax assets will not be realized. A valuation allowance is provided for deferred income taxes when, in our judgment, based upon currently available information and other factors, it is more likely than not that all or a portion of such deferred income tax assets will not be realized. The determination of the need for a valuation allowance is based on an on-going evaluation of current information including, among other things, historical operating results, estimates of future earnings in different taxing jurisdictions and the expected timing of the reversals of temporary differences. We believe that the determination to record a valuation allowance to reduce a deferred income tax asset is a significant accounting estimate because it is based, among other things, on an estimate of future taxable income in the United States and certain other jurisdictions, which is susceptible to change and may or may not occur, and because the impact of adjusting a valuation allowance may be material. Our valuation allowances totaled $3.4 million as of June 29, 2014 and December 29, 2013, and relate to state deferred tax assets for net operating loss and tax credit carryforwards that are not expected to be realized due to changes in tax law and cessation of business in Kansas.

We record uncertain tax positions in accordance with US GAAP on the basis of a two-step process whereby (1) we determine whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, we recognize the largest amount of tax benefit that is more than 50 percent likely to be realized upon ultimate settlement with the related tax authority. If a position does not meet the more likely than not threshold for recognition in step one, no benefit is recorded until the first subsequent period in which the more likely than not standard is met, the issue is resolved with the taxing authority, or the statute of limitations expires. Positions previously recognized are derecognized when we subsequently determine the position no longer is more likely than not to be sustained. Evaluation of tax positions, their technical merits, and measurements using cumulative probability are highly subjective management estimates. Actual results could differ materially from these estimates.

Presently, we have not recorded a deferred tax liability for temporary differences related to investments in foreign subsidiaries that are essentially permanent in duration. These temporary differences may become taxable upon a repatriation of earnings from the subsidiaries or a sale or liquidation of the subsidiaries. At this time, the company does not have any plans to repatriate additional income from its foreign subsidiaries.

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For the thirteen weeks ended June 29, 2014 the provision for income taxes was $3.6 million, which was an effective income tax rate of 42 percent. For the twenty-six weeks ended June 29, 2014 the provision for income taxes was $6.9 million, which was an effective income tax rate of 41 percent. The effective tax rates for the thirteen and twenty-six week periods ended June 29, 2014 were higher than the federal statutory rate as a result of non-deductible expenses primarily related to compensation deduction limitations and recent tax law changes in Mexico, state income taxes (net of federal tax benefit) and interest and penalties on unrecognized tax benefits, partially offset by foreign income taxed at rates that are lower than the U. S. statutory rates.

For the thirteen weeks ended June 30, 2013 the provision for income taxes was $3.5 million, which was an effective income tax rate of 36 percent. The effective tax rate was higher than the federal statutory rate as a result of non-deductible expenses incurred during the quarter and interest on unrecognized tax benefits, partially offset by income tax credits and foreign income taxes that are taxed at rates lower than the U. S. statutory rates. The provision for income taxes for the twenty-six weeks ended June 30, 2013 was $5.5 million, which was an effective income tax rate of 33 percent. The effective tax rate was lower than the federal statutory rate as a result of the favorable impact of the settlement of a tax audit at our Mexican subsidiary discussed below, foreign income taxes (taxed at rates lower than the U. S. statutory rates) and tax credits recognized as a result of the 2013 enactment of the American Taxpayer Relief Act of 2012, partially offset by state income taxes (net of federal tax benefit) and non-deductible expenses incurred during the period.

During the first two quarters of 2014, the liability for uncertain tax positions increased by $0.9 million to $16.0 million from $15.1 million at December 29, 2013. The increase primarily resulted from $0.6 million of interest and penalties which were recognized in income tax expense during the first two quarters of 2014 and a $0.3 million increase for tax positions taken in the current period. During February 2013, Mexico's Tax Administration Service (Servicio de Administracion Tributaria, or "SAT"), finalized its examination of the 2007 tax year of Superior Industries de Mexico S.A. de C.V., our wholly-owned Mexican subsidiary. As a result, we reached a settlement with SAT for the 2007 tax year and made a cash payment of $0.3 million during the first quarter of 2013.

We conduct business internationally and, as a result, one or more of our subsidiaries files income tax returns in U.S. federal, U.S. state and certain foreign jurisdictions. Accordingly, in the normal course of business, we are subject to examination by taxing authorities throughout the world, including taxing authorities in Mexico, the Netherlands, India and the United States. We are no longer open for examination by taxing authorities regarding any U.S. federal income tax returns for years before 2010 while the years open for examination under various state and local jurisdictions vary. The Internal Revenue Service ("IRS") is currently conducting an audit of the 2011 tax year of Superior Industries International and subsidiaries. We expect this IRS audit to be completed in 2014. We expect approximately $7.7 million of unrecognized tax benefits related to our U.S. and Mexico operations will be recognized in the twelve month period ending June 28, 2015 due to the expiration of certain statutes of limitations or due to settlement of uncertain tax positions.

Net Income

Net income in the second quarter of 2014 was $5.0 million, or $0.18 per diluted share, compared to net income in the second quarter of 2013 of $6.3 million, or $0.23 per diluted share. Net income in the first half of 2014 was $9.9 million, or $0.36 per diluted share, and included income tax expense of $6.9 million, compared to net income in the first half of 2013 of $11.3 million, or $0.41 per diluted share, which included income tax expense of $5.5 million.

Financial Condition, Liquidity and Capital Resources

Our sources of liquidity primarily include cash, cash equivalents and short-term investments and net cash provided by operating activities and, from time to time, other external sources of funds. Working capital (current assets minus current liabilities) and our current ratio (current assets divided by current liabilities) were $233.6 million and 3.4:1, respectively, at June 29, 2014, versus $284.8 million and 3.9:1 at December 29, 2013. We have no long-term debt. As of June 29, 2014, our cash, cash equivalents and short-term investments totaled $130.4 million compared to $203.1 million at December 29, 2013 and $206.5 million at June 30, 2013.

Working capital decreased in the first half of 2014 and primarily reflects payments related to constructing and equipping our new wheel plant in Mexico discussed below, which decreased cash during the period. The change in working capital also reflects payments to repurchase our common stock, discussed below, partially offset by increases in accounts receivable. At this time, we expect all working capital requirements, funds required for investing activities and cash dividend payments for 2014 to be funded from internally generated funds or existing cash, cash equivalents and short-term investments. Depending on future requirements, the company may seek to implement some form of financing as it reviews its future capital allocation and capital structure. The

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level of change in cash and cash provided by operating activities experienced in the first half of 2014 may not necessarily be indicative of future results.

During the first half of 2013 we announced our plans to invest between $125 million and $135 million to build a new manufacturing facility in Mexico, supported by the expectation of continued strength in demand for aluminum wheels in the North American market. In June 2013 we entered into a contract for the construction of the new facility and subsequently entered into contracts for the purchase of equipment for the new facility. Through the end of the first half of 2014, the total value of these contracts was approximately $115.7 million, of which $75.4 million was paid in cash in 2013 and 2014, with the remaining payments expected to be made over the next 6 months. We currently project the new facility will be operational in late 2014.

On March 27, 2013, our Board of Directors approved a new stock repurchase program authorizing the repurchase of up to $30.0 million of our common stock. Under the program, we may repurchase common stock from time to time on the open market or in private transactions. The timing and extent of the repurchases will depend upon market conditions and other corporate considerations in our sole discretion. As of June 29, 2014, additional shares with a total cost of $8.9 million may be purchased under the program authorization. Through June 29, 2014, we repurchased 1,074,000 shares of our common stock at a total investment of $21.1 million.

The following table presents a summary of the net increase in cash and cash equivalents in the periods presented:

(Dollars in thousands)	Twenty-six Weeks Ended		
	June 29, 2014	June 30, 2013	Change
Net cash provided by operating activities	$1,541	$15,366	$(13,825)
Net cash used in investing activities	(54,962)	(16,841)	(38,121)
Net cash (used in) provided by financing activities	(19,258)	1,457	(20,715)
Effect of exchange rate changes on cash	75	(810)	885
Net decrease in cash and cash equivalents	$(72,604)	$(828)	$(71,776)

Operating Activities

Net cash provided by operating activities was $1.5 million for the twenty-six week period ended June 29, 2014, compared to $15.4 million for the comparable period a year ago. Compared to the first half of 2013, the $13.8 million decrease in cash from operating activities in the first half of 2014 resulted primarily from unfavorable fluctuations in accounts receivable, accounts payable and inventory totaling $22.0 million, partially offset by a favorable change in income taxes receivable of $6.7 million.

Investing Activities

Our principal investing activities during the twenty-six week period ended June 29, 2014 included the funding of $55.5 million of capital expenditures, including payments totaling $39.6 million related to our new wheel plant discussed above, and the purchase of $2.8 million of certificates of deposit, offset by the receipt of $2.8 million cash proceeds from maturing certificates of deposit and $0.4 million cash proceeds from a life insurance policy. Investing activities during the comparable period a year ago included the funding of $17.1 million of capital expenditures and the purchase of $2.8 million of certificates of deposit, offset by the receipt of $2.8 million cash proceeds from maturing certificates of deposit and $0.3 million cash proceeds from a life insurance policy.

Financing Activities

Financing activities during the twenty-six week period ended June 29, 2014 consisted of the repurchase of our common stock for cash totaling $13.0 million and the payment of cash dividends on our common stock totaling $9.8 million, partially offset by receipt of cash proceeds from the exercise of stock options totaling $3.5 million. Financing activities during the twenty-six week period ended June 30, 2013 consisted of the receipt of cash proceeds from the exercise of stock options totaling $1.1 million and excess tax benefits from option exercises of $0.3 million. In December 2012 the company's Board of Directors approved an accelerated payment of the 2013 regular cash dividends into 2012. Accordingly, a payment of $17.5 million, representing the 2013 regular cash dividend of $0.64, was made in December 2012.

Critical Accounting Estimates

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The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to apply significant judgment in making estimates and assumptions that affect amounts reported therein, as well as financial information included in this Management's Discussion and Analysis of Financial Condition and Results of Operations. These estimates and assumptions, which are based upon historical experience, industry trends, terms of various past and present agreements and contracts, and information available from other sources that are believed to be reasonable under the circumstances, form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent through other sources. There can be no assurance that actual results reported in the future will not differ from these estimates, or that future changes in these estimates will not adversely impact our results of operations or financial condition.

New Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board issued an Accounting Standards Update ("ASU") entitled "Revenue from Contracts with Customers." The ASU requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. For a public entity, the amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. We are evaluating the impact this guidance will have on our financial position and statement of operations.

Other Commitments

Steven J. Borick, Separation Agreement

On October 14, 2013, the company and Steven J. Borick entered into a Separation Agreement (the "Separation Agreement"), providing for Mr. Borick's separation from employment as the company's President and Chief Executive Officer. Mr. Borick's separation was effective March 31, 2014.

In accordance with the Separation Agreement, in addition to payment of his salary and accrued vacation through his separation date, the company will pay or provided Mr. Borick with the following upon his separation:

- A lump-sum cash payment of $1,345,833,
- Mr. Borick's 2013 annual incentive bonus,
- A grant of a number of shares of company common stock equal to the Black-Scholes value of an annual award of 120,000 stock options divided by the company's closing stock price on the separation date (See PART I - Financial Information, Item 1. Financial Statements, Note 4 - Stock-Based Compensation), and
- Vesting of all of Mr. Borick's unvested stock options and unvested restricted stock.

In the first quarter of 2014, the company accrued an additional $1.1 million of compensation expense in connection with Mr. Borick's Separation Agreement.

Donald J. Stebbins, Executive Employment Agreement

On April 30, 2014, we entered into an Executive Employment Agreement (the "Employment Agreement") with Donald J. Stebbins in connection with his appointment as President and Chief Executive Officer of the company. The Employment Agreement became effective May 5, 2014 and is for a three year term that expires on April 30, 2017, with additional one-year automatic renewals unless either Mr. Stebbins or the company provides advance notice of nonrenewal of the Employment Agreement. The Employment Agreement provides for an annual base salary of $900,000. Mr. Stebbins may receive annual bonuses based on attainment of performance goals, determined by the company's independent compensation committee, in the amount of 80 percent of annual base salary at threshold level performance, 100 percent of annual base salary at target level performance, and up to 200 percent of annual base salary for performance substantially above target level.

Mr. Stebbins received inducement grants of restricted stock for 50,000 shares vesting April 30, 2017, and an additional number of shares of 82,455 determined by dividing $1,602,920 by the per share value of the company's common stock on May 5, 2014, with the additional shares vesting on December 31, 2016. Beginning in 2015, Mr.

Stebbins will be granted restricted stock unit awards each year under Superior's 2008 Equity Incentive Plan, or any successor equity plan. Under the Employment Agreement, Mr. Stebbins is to be granted time-vested restricted stock units each year, cliff vesting at the third fiscal year end following grant, for a number of shares equal to 66.67 percent of his annual base salary divided by the per share value of Superior’s common stock on the date of grant. In addition, Mr. Stebbins is to be granted performance-vested restricted stock units each year, vesting based on company performance goals established by the independent compensation committee during the three fiscal years following grant, for a maximum number of shares equal to 200 percent of his annual base salary divided by the per share value of Superior’s

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common stock on the date of grant. In general, the equity awards vest only if Mr. Stebbins continues in employment with the company through the vesting date or end of the performance period.
The Employment Agreement provides Mr. Stebbins a lump sum severance payment of one year's base salary plus a prorated amount of his current year annual bonus at target level, and 12 months' health care continuation, if he is terminated without "cause" or resigns for "good reason" other than within one year following a change in control of Superior. The severance payment is two year's base salary and two times current year annual bonus at target level, and health care continuation is 24 months, if Mr. Stebbins is terminated without "cause" or resigns for "good reason" within one year following a change in control of Superior. These severance payments and benefits, and the acceleration of equity awards described above, are conditioned upon Mr. Stebbins providing Superior a release of claims.
Risk Management

We are subject to various risks and uncertainties in the ordinary course of business due, in part, to the competitive global nature of the industry in which we operate, changing commodity prices for the materials used in the manufacture of our products and the development of new products.

The functional currency of certain foreign operations in Mexico is the Mexican peso. The settlement of accounts receivable and accounts payable for these operations requires the transfer of funds denominated in the Mexican peso, the value of which was unchanged in relation to the U.S. dollar in the first two quarters of 2014. Foreign currency transaction losses totaled $0.2 million in the first two quarters of 2014 while transaction gains totaled $0.4 million in the first two quarters of 2013. All transaction gains and losses are included in other income (expense) in the condensed consolidated income statements.

As it relates to foreign currency translation gains and losses, however, since 1990, the Mexican peso has experienced periods of relative stability followed by periods of major declines in value. The impact of these changes in value relative to our Mexico operations resulted in a cumulative unrealized translation loss at June 29, 2014 of $56.6 million. Translation gains and losses are included in other comprehensive income in the condensed consolidated statements of comprehensive income.

When market conditions warrant, we may also enter into purchase commitments to secure the supply of certain commodities used in the manufacture of our products, such as aluminum, natural gas and other raw materials. We currently have several purchase commitments in place for the delivery of natural gas through 2015. These natural gas contracts are considered to be derivatives under U.S. GAAP, and when entering into these contracts, we expected to take full delivery of the contracted quantities of natural gas over the normal course of business. Accordingly, at inception, these contracts qualified for the normal purchase, normal sale ("NPNS") exemption provided for under U.S. GAAP. As such, we do not account for these purchase commitments as derivatives unless there is a change in facts or circumstances in regard to our intent or ability to use the contracted quantities of natural gas over the normal course of business. Based on the quarterly analysis of our estimated future production levels, we believe that our remaining natural gas purchase commitments that were in effect as of June 29, 2014 will continue to qualify for the NPNS exemption since we can assert that it is probable we will take full delivery of the contracted quantities.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency. A significant portion of our business operations are conducted in Mexico. As a result, we have a certain degree of market risk with respect to our cash flows due to changes in foreign currency exchange rates when transactions are denominated in currencies other than our functional currency, including inter-company transactions. Historically, we have not actively engaged in substantial exchange rate hedging activities and, at June 29, 2014, we had not entered into any foreign exchange contracts.

During the first two quarters of 2014, the Mexican peso exchange rate to U.S. dollar averaged 13.1 pesos per U.S. dollar. Based on the balance sheet at June 29, 2014, a 10 percent change in the relationship between the peso and the U.S. dollar may result in a translation impact of between $10.6 million and $13.0 million, which would be recognized in other comprehensive income.

Our business requires us to settle transactions between currencies in both directions, i.e., peso to U.S. dollar and vice versa. To the greatest extent possible, we attempt to match the timing of transaction settlements between currencies to create a “natural hedge.” Foreign currency transaction losses totaled $0.2 million in the first two quarters of 2014. Based on the current business model and levels of production and sales activity, the net imbalance between currencies depends on specific circumstances and there can be no assurances that the net transaction balance will not change significantly in the future.

Natural Gas Purchase Commitments. When market conditions warrant, we enter into purchase commitments to secure the supply of certain commodities used in the manufacture of our products, such as natural gas. However, we do not enter into derivatives or other financial instrument transactions for speculative purposes. At June 29, 2014, we had several purchase commitments in place for the delivery of natural gas through 2015 for a total cost of $2.1 million. These fixed price natural gas contracts may expose us to higher costs that cannot be recouped in selling prices in the event that the market price of natural gas declines below the contract price. As of June 29, 2014, we have fixed price natural gas purchase agreements for deliveries through 2015 that represent approximately 10 percent of our estimated natural gas consumption through 2015.

Also see Item 7A. Quantitative and Qualitative Disclosures About Market Risk in Part II of our 2013 Annual Report on Form 10-K and Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations – "Risk Management" in this Quarterly Report on Form 10-Q.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The company's management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 29, 2014. Our disclosure controls and procedures are designed to ensure that information required to be disclosed in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to our management, including our interim Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

The evaluation of our disclosure controls and procedures included a review of their objectives and design, our implementation of the controls and procedures and the effect of the controls and procedures on the information generated for use in this report. In the course of the evaluation, we sought to identify whether we had any data errors, control problems or acts of fraud and to confirm that appropriate corrective action, including process improvements, was being undertaken if needed. This type of evaluation is performed on a quarterly basis so that conclusions concerning the effectiveness of our disclosure controls and procedures can be reported in our Quarterly Reports on Form 10-Q and our Annual Reports on Form 10-K. Many of the components of our disclosure controls and procedures are also evaluated by our internal audit department, our legal department and by personnel in our finance organization. The overall goals of these various evaluation activities are to monitor our disclosure controls and procedures on an ongoing basis, and to maintain them as dynamic systems that change as conditions warrant.

Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of June 29, 2014, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting during the most recent fiscal quarter ended June 29, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

We are party to various legal and environmental proceedings incidental to our business. Certain claims, suits and complaints arising in the ordinary course of business have been filed or are pending against us. Based on facts now known, we believe all such matters are adequately provided for, covered by insurance, are without merit and/or involve such amounts that would not materially adversely affect our consolidated results of operations, cash flows or financial position.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Item 1A – Risk Factors in Part I of our 2013 Annual Report on Form 10-K, which could materially affect our business, financial condition or future results. There have been no material changes from the risk factors described in our 2013 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

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Recent Sales of Unregistered Securities

During the first two quarters of 2014, there were no sales of unregistered securities.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

On March 27, 2013, our Board of Directors approved a new stock repurchase program (the "Repurchase Program") authorizing the repurchase of up to $30.0 million of our common stock. Under the Repurchase Program, we may repurchase common stock from time to time on the open market or in private transactions. Currently, we expect to fund the repurchases through available cash, although credit options are being evaluated in the context of total capital needs. The timing and extent of the repurchases will depend upon market conditions and other corporate considerations in our sole discretion. Through June 29, 2014, we repurchased and retired 1,074,000 shares under the program at a total cost of $21.1 million.
The following table provides common stock repurchases made by or on behalf of the company during the three months ended June 29, 2014:

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans and Programs	Maximum Approximate Dollar Value of Shares That May Yet be Purchased Under the Plans or Programs
(Thousands of dollars, except per share amounts)				
March 31, 2014 - April 27, 2014	—	$—	—	
April 28, 2014 - May 25, 2014	76,403	$19.60	76,403	
May 26, 2014 - June 29, 2014	483,895	$19.92	483,895	
Total	560,298		560,298	$8,888

Item 6. Exhibits

3.1	Restated Articles of Incorporation of the Registrant (Incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K filed May 23, 2013).
3.2	Amended and Restated By-Laws of the Registrant (Incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K filed May 25, 2010).
31.1	Certification of Donald J. Stebbins, Chief Executive Officer and President, Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as Adopted Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2	Certification of Kerry A. Shiba, Executive Vice President and Chief Financial Officer, Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as Adopted Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.1	Certification of Donald J. Stebbins, Chief Executive Officer and President, and Kerry Shiba, Executive Vice President and Chief Financial Officer, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
101	Interactive data file (furnished electronically herewith pursuant to Rule 406T of Regulation S-T).

Items 3, 4, and 5 are not applicable and have been omitted.

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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 thereunto duly authorized.

SUPERIOR INDUSTRIES INTERNATIONAL, INC.
(Registrant)

Date: July 31, 2014	/s/ Donald J. Stebbins Donald J. Stebbins Chief Executive Officer and President
Date: July 31, 2014	/s/ Kerry A. Shiba Kerry A. Shiba Executive Vice President and Chief Financial Officer