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SOMANETICS CORP
Form 10-Q
July 10, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

(x) Quarterly report pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934
For the quarterly period ended MAY 31, 2002

OR

() Transition report pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934
For the transition period from _____ to

Commission file number 0-19095

SOMANETICS CORPORATION
(Exact name of registrant as specified in its charter)

MICHIGAN
(State or other jurisdiction of
incorporation or organization)

38-2394784
(I.R.S. Employer
Identification No.)

1653 EAST MAPLE ROAD,
TROY, MICHIGAN
48083-4208
(Address of principal executive offices)
(Zip Code)

(248) 689-3050
(Registrant's telephone number, including area code)

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

Yes X No
----- -----

Number of common shares outstanding at July 10, 2002: 9,077,863

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PART I FINANCIAL INFORMATION

SOMANETICS CORPORATION

BALANCE SHEETS

ASSETS

CURRENT ASSETS:

Cash and cash equivalents
Accounts receivable
Inventory
Prepaid expenses

Total current assets

PROPERTY AND EQUIPMENT (at cost):

Machinery and equipment
Furniture and fixtures
Leasehold improvements

Total
Less accumulated depreciation and amortization

Net property and equipment

OTHER ASSETS:

Intangible assets, net
Other

Total other assets

TOTAL ASSETS

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:

Accounts payable
Accrued liabilities

Total current liabilities

COMMITMENTS AND CONTINGENCIES

SHAREHOLDERS' EQUITY:

Preferred shares; authorized, 1,000,000 shares of \$.01 par value;
no shares issued or outstanding
Common shares; authorized, 20,000,000 shares of \$.01 par value;
issued and outstanding, 9,077,863 shares at May 31, 2002,
and 8,075,055 at November 30, 2001
Additional paid-in capital
Accumulated deficit

Total shareholders' equity

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY

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See notes to financial statements

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SOMANETICS CORPORATION STATEMENTS OF OPERATIONS (Unaudited)

	Three Months Ended May 31,	
	2002	2001
NET REVENUES	\$ 1,659,606	\$ 1,261,513
COST OF SALES	542,616	417,679
GROSS MARGIN	1,116,990	843,834
OPERATING EXPENSES:		
Research, development and engineering	103,839	194,816
Selling, general and administrative	1,422,685	1,505,019
Total operating expenses	1,526,524	1,699,835
OPERATING LOSS	(409,534)	(856,001)
OTHER INCOME (EXPENSE):		
Interest expense	--	(2,458)
Interest income	20,281	8,684
Total other income	20,281	6,226
NET LOSS	\$ (389,253)	\$ (849,775)
NET LOSS PER COMMON SHARE-		
BASIC AND DILUTED	\$ (0.04)	\$ (0.11)
WEIGHTED AVERAGE SHARES		
OUTSTANDING-BASIC AND DILUTED	9,077,863	7,513,396

See notes to financial statements

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SOMANETICS CORPORATION

STATEMENTS OF CASH FLOWS
(UNAUDITED)

CASH FLOWS FROM OPERATING ACTIVITIES:

Net loss \$
Adjustments to reconcile net loss to net cash used in
operations:
 Depreciation and amortization
 Compensation expense for non-employee stock options
Changes in assets and liabilities:
 Accounts receivable decrease
 Inventory (increase)
 Prepaid expenses (increase) decrease
 Other assets decrease
 Accounts payable increase (decrease)
 Accrued liabilities increase (decrease)

 Net cash (used in) operations

CASH FLOWS FROM INVESTING ACTIVITIES:

Acquisition of property and equipment (net)

 Net cash (used in) investing activities

CASH FLOWS FROM FINANCING ACTIVITIES:

Proceeds from issuance of common shares

 Net cash provided by financing activities

NET INCREASE IN CASH AND CASH
EQUIVALENTS

CASH AND CASH EQUIVALENTS, BEGINNING
OF PERIOD

CASH AND CASH EQUIVALENTS, END
OF PERIOD \$
==

See notes to financial statements

SOMANETICS CORPORATION
NOTES TO FINANCIAL STATEMENTS
(UNAUDITED)

MAY 31, 2002

1. ORGANIZATION AND OPERATIONS

We are a Michigan corporation that was formed in January 1982. We develop, manufacture and market the INVOS(R) Cerebral Oximeter, the only non-invasive patient monitoring system commercially available in the United States that continuously measures changes in the blood oxygen level in the brain. The principal markets for our products are the United States, Europe, and Japan. The Cerebral Oximeter is based on our proprietary In Vivo Optical Spectroscopy, or INVOS, technology. INVOS analyzes various characteristics of human blood and tissue by measuring and analyzing low-intensity visible and near infrared light transmitted into portions of the body.

We are also developing and marketing the CorRestore(TM) System for use in cardiac repair and reconstruction, including heart surgeries called surgical ventricular restoration, or SVR. We entered into a License Agreement as of June 2, 2000 with the inventors and their Company, CorRestore LLC. The license grants us worldwide, royalty-bearing licenses to specified rights relating to the CorRestore System and related products and accessories for SVR, subject to the terms and conditions of the license agreement. In November 2001 we received clearance from the FDA to market the CorRestore patch in the United States.

2. FINANCIAL STATEMENT PRESENTATION

We prepared our unaudited interim financial statements pursuant to the Securities and Exchange Commission's rules. Accordingly, they do not include all of the information and footnotes normally included in our annual financial statements prepared in accordance with generally accepted accounting principles. We believe, however, that the disclosures are adequate to make the information presented not misleading.

The unaudited interim financial statements in this report reflect all adjustments which are, in our opinion, necessary to a fair statement of the results for the interim periods presented. All of these adjustments that are material are of a normal recurring nature. Our operating results for the six-month period ended May 31, 2002 do not necessarily indicate the results that you should expect for the year ending November 30, 2002. You should read the unaudited interim financial statements together with the financial statements and related footnotes for the year ended November 30, 2001 included in our Annual Report on Form 10-K for the fiscal year ended November 30, 2001.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Inventory is stated at the lower of cost or market on a first-in, first-out (FIFO) basis. Inventory consists of:

May 31, 2002

November 30, 2001

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Finished goods.....	\$ 346,187	\$ 50,314
Work in process.....	155,868	215,313
Purchased components.....	623,842	528,130
	-----	-----
Total.....	\$1,125,897	\$ 793,757
	=====	=====

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SOMANETICS CORPORATION

NOTES TO FINANCIAL STATEMENTS
(UNAUDITED)

MAY 31, 2002

Intangible Assets consist of patents and trademarks, and license acquisition costs. Patents and trademarks are recorded at cost and are being amortized on the straight-line method over 17 years. The carrying amount and accumulated amortization of these patents and trademarks is as follows:

	May 31, 2002	November 30,
	-----	-----
Patents and trademarks	111,733	111,733
Less accumulated amortization	(70,620)	(67,163)
	-----	-----
Total	\$ 41,113	\$ 44,570
	=====	=====

License acquisition costs are related to our acquisition of worldwide, royalty-bearing licenses to specified rights relating to the CorRestore(TM) System, and related products and accessories. In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets." This statement establishes accounting and reporting standards for goodwill and other intangible assets. We adopted this statement in the first quarter of fiscal 2002. The effect of adopting this statement has been to discontinue amortizing our license acquisition costs related to our acquisition of worldwide, royalty-bearing licenses to specified rights relating to the CorRestore System and related products and accessories described above because we believe these licenses have an indefinite life. The carrying amount and accumulated amortization of these license acquisition costs is as follows:

	May 31, 2002	November 30,
	-----	-----
License acquisition costs	\$ 1,213,370	\$ 1,213,
Less accumulated amortization	(329,070)	(329,
	-----	-----
Total	\$ 884,300	\$ 884,
	=====	=====

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Amortization expense for the three months ended May 31, 2002 was approximately \$1,700, and for the three months ended May 31, 2001 was approximately \$56,600. Amortization expense for the six months ended May 31, 2002 was approximately \$3,500, and for the six months ended May 31, 2001 was approximately \$113,100. Net loss for the three months ended May 31, 2001, excluding the effect of amortizing our license acquisition costs, would have been approximately \$795,000, or \$(.11) per common share. Net loss for the six months ended May 31, 2001, excluding the effect of amortizing our license acquisition costs, would have been approximately \$1,451,000, or \$(.20) per common share. Amortization expense for each of the next five fiscal years is expected to be approximately \$6,900 per year.

Intangible assets are reviewed periodically for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recovered.

Loss Per Common Share - basic and diluted, is computed using the weighted average number of common shares outstanding during each period. Common shares issuable under stock options and warrants have not been included in the computation of the net loss per common share - diluted, because such inclusion would be antidilutive. As of May 31, 2002 and May 31, 2001, we had outstanding 5,070,050 and 2,685,515, respectively, of warrants and options to purchase common shares.

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SOMANETICS CORPORATION

NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

MAY 31, 2002

Accounting Pronouncements As described above, effective December 1, 2001, we adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement is effective for fiscal years beginning after December 15, 2001, and replaces Statement No. 121 and provisions of APB Opinion No. 30 for the disposal of segments of a business. The statement creates one accounting model, based on the framework established in Statement No. 121, to be applied to all long-lived assets including discontinued operations. This statement is effective for our financial statements for the fiscal year ending November 30, 2003. We have not yet determined the impact of this statement on our financial statements.

Reclassifications - Certain reclassifications have been made to the financial statements for 2001 to conform to the 2002 presentation.

4. ACCRUED LIABILITIES

Accrued liabilities consist of the following:

May 31, 2002

November 30, 2001

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Accrued sales commissions	\$ 53,064	\$ 60,109
Accrued insurance	36,109	24,570
Accrued incentive	34,988	--
Accrued royalty	4,505	--
Accrued warranty	5,300	7,750
	-----	-----
Total	\$133,966	\$ 92,429
	=====	=====

5. COMMITMENTS AND CONTINGENCIES

We may become subject to products liability claims by patients or physicians, and may become a defendant in products liability or malpractice litigation. We have obtained products liability insurance and an umbrella policy. We might not be able to maintain such insurance or such insurance might not be sufficient to protect us against products liability.

6. COMMON STOCK

On January 16, 2002, we completed a public offering of 1,000,000 newly-issued common shares at a price of \$4.25 per share, for gross proceeds of \$4,250,000. Our net proceeds, after deducting the placement agent's commission and the expenses of the offering, were approximately \$3,680,000. Brean Murray & Co., Inc. was our exclusive placement agent for the offering and received for its services (1) \$340,000 as a placement agent fee, and (2) warrants to purchase 100,000 common shares at \$5.10 per share exercisable during the four-year period beginning January 11, 2003. A. Brean Murray, one of our directors, and his wife control Brean Murray & Co., Inc. As a result of this offering, Kingsbridge Capital Limited's warrant has been adjusted, and Kingsbridge is now entitled to purchase 205,097 common shares at a purchase price of \$4.25 per share.

In February 2002, one of our former employees exercised stock options to purchase 2,833 newly-issued common shares.

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SOMANETICS CORPORATION

NOTES TO FINANCIAL STATEMENTS
(UNAUDITED)

MAY 31, 2002

On April 17, 2002, our shareholders approved an amendment to the Somanetics Corporation 1997 Stock Option Plan to increase the number of common shares reserved for issuance pursuant to the exercise of options granted under the 1997 Plan by 450,000 shares, from 1,660,000 to 2,110,000 shares.

Effective May 10, 2002, we granted 10-year options under the 1997 Stock Option Plan to purchase 388,500 common shares, to 17 of our key employees (including officers) at an exercise price of \$2.95 per share (the closing sale price of the common shares as of the date of grant). In addition, effective May 10, 2002, we granted to six of our directors, who are not officers or employees, 10-year options under the 1997 Stock Option Plan to purchase an aggregate of 21,000 common shares at an exercise price of \$2.95 per share (the closing sale price of the common shares as of the date of grant).

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7. SEGMENT INFORMATION

We operate our business in one reportable segment, the development, manufacture and marketing of medical devices. Each of our two product lines have similar characteristics, customers, distribution and marketing strategies, and are subject to similar regulatory requirements. In addition, in making operating and strategic decisions, our management evaluates net revenues based on the worldwide net revenues of each major product line, and profitability on an enterprise-wide basis due to shared costs. Approximately 97% of our net revenues in the first six months of fiscal 2002 were derived from our INVOS Cerebral Oximeter product line, compared to 100% of our net revenues in the first six months of fiscal 2001.

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SOMANETICS CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

MAY 31, 2002

Some of the statements in this report are forward-looking statements. These forward-looking statements include statements relating to our performance in this Management's Discussion and Analysis of Financial Condition and Results of Operations. In addition, we may make forward-looking statements in future filings with the Securities and Exchange Commission and in written material, press releases and oral statements issued by us or on our behalf. Forward-looking statements include statements regarding the intent, belief or current expectations of us or our officers, including statements preceded by, followed by or including forward-looking terminology such as "may," "will," "should," "believe," "expect," "anticipate," "estimate," "continue," "predict" or similar expressions, with respect to various matters.

It is important to note that our actual results could differ materially from those anticipated from the forward-looking statements depending on various important factors. These important factors include our history of losses and ability to continue as a going concern, our current dependence on the Cerebral Oximeter and SomaSensor, the challenges associated with developing new products, the uncertainty of acceptance of our products by the medical community, the lengthy sales cycle for our products, competition in our markets, our dependence on our distributors, and the other factors discussed under the caption "Risk Factors" and elsewhere in our Registration Statement on Form S-1 (file no. 333-74788) effective January 11, 2002 and elsewhere in this report.

All forward-looking statements in this report are based on information available to us on the date of this report. We do not undertake to update any forward-looking statements that may be made by us or on our behalf in this report or otherwise. In addition, please note that matters set forth under the caption "Risk Factors" in our registration statement constitute cautionary statements identifying important factors with respect to the forward-looking statements, including certain risks and uncertainties, that could cause actual results to differ materially from those in such forward-looking statements.

RESULTS OF OPERATIONS

OVERVIEW

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We develop, manufacture and market the INVOS Cerebral Oximeter, the only non-invasive patient monitoring system commercially available in the United States that continuously measures changes in the blood oxygen level in the brain. We are also developing and marketing the CorRestore System for use in cardiac repair and reconstruction, including heart surgeries called surgical ventricular restoration, or SVR. In November 2001 we received clearance from the FDA to market the CorRestore patch in the United States.

During fiscal 2001 and the first quarter of fiscal 2002, our primary activities consisted of sales and marketing of the Cerebral Oximeter and related disposable SomaSensor, and developing the CorRestore System. During the second quarter of fiscal 2002, our primary activities consisted of sales and marketing of the Cerebral Oximeter, the disposable SomaSensor, and the CorRestore System. We had an accumulated deficit of \$53,198,418 through May 31, 2002.

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SOMANETICS CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

MAY 31, 2002

We derive our revenues from sales of Cerebral Oximeters, SomaSensors, and CorRestore Systems to our distributors and to hospitals in the United States through our direct sales employees and independent sales representatives. Payment terms are generally net 30 days for United States sales and net 60 days or longer for international sales. Our primary expenses, excluding the cost of our products, are selling, general and administrative and research, development and engineering.

THREE MONTHS ENDED MAY 31, 2002 COMPARED TO THREE MONTHS ENDED MAY 31, 2001

Our net revenues increased approximately \$398,000, or 32%, from \$1,261,513 in the three-month period ended May 31, 2001 to \$1,659,606 in the three-month period ended May 31, 2002. The increase in net revenues is primarily attributable to:

- an increase in international sales of approximately \$288,000, from approximately \$75,000 in the second quarter of fiscal 2001 to approximately \$363,000 in the second quarter of fiscal 2002. This increase is primarily due to increased purchases by Baxter Limited in Japan and Tyco Healthcare, and
- an increase in United States sales of approximately \$110,000, from approximately \$1,186,000 in the second quarter of fiscal 2001 to approximately \$1,296,000 in the second quarter of fiscal 2002. This increase is primarily due to a 54% increase in sales of the disposable SomaSensor and approximately \$45,000 in CorRestore System revenues in the second quarter of fiscal 2002. The increase in United States sales was partially offset by a 66% decrease in sales of the Cerebral Oximeter, primarily due to approximately \$180,000 in stocking orders to independent representatives in the second quarter of fiscal 2001. Based on CorRestore System revenues to date, we believe that CorRestore System revenues for fiscal 2002 will be significantly less than previously expected.

A 14% increase in the average selling price of SomaSensors in the United States, primarily due to the 25% increase in the suggested retail price of the SomaSensor in the United States effective September 1, 2001, was substantially

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offset by increased SomaSensor sales to international distributors, which have lower average selling prices.

Sales of our products as a percentage of net revenues were as follows:

PRODUCT -----	PERCENT OF NET REVENUE SECOND QUARTER OF FISCAL 2002 -----	2001 -----
SomaSensors.....	76%	59%
Model 4100 Cerebral Oximeters.....	13%	14%
Model 5100 Cerebral Oximeters.....	8%	27%
CorRestore Systems.....	3%	0%
Total.....	----- 100% =====	----- 100% =====

Approximately 22% of our net revenues in the second quarter of fiscal 2002 were export sales, compared to approximately 6% of our net revenues in the second quarter of fiscal 2001. One international distributor accounted for approximately 12% of net revenues for the three months ended May 31, 2002.

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SOMANETICS CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

MAY 31, 2002

Gross margin as a percentage of net revenues was approximately 67% for the quarter ended May 31, 2002 and approximately 67% for the quarter ended May 31, 2001. Although we experienced a 54% increase in sales of the disposable SomaSensor in the United States during the second quarter of fiscal 2002, and this latest model SomaSensor is less costly to manufacture and has a higher U.S. selling price than the model which was sold in the second quarter of fiscal 2001, gross margin as a percentage of net revenues remained constant primarily due to a change in the sales mix between sales to international distributors, which have lower average selling prices, and sales in the United States.

Our research, development and engineering expenses decreased approximately \$91,000, or 47%, from \$194,816 for the three months ended May 31, 2001 to \$103,839 for the three months ended May 31, 2002. The decrease is primarily attributable to approximately \$94,000 in decreased costs associated with the development of the CorRestore System.

Selling, general and administrative expenses decreased approximately \$82,000, or 5%, from \$1,505,019 for the three months ended May 31, 2001 to \$1,422,685 for the three months ended May 31, 2002. The decrease in selling, general and administrative expense is primarily attributable to

- a \$200,000 termination fee paid in fiscal 2001 related to the Kingsbridge Capital Limited Private Equity Line,
- a \$55,000 decrease in intangible amortization expense related to

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license acquisition costs as a result of our adoption of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets." Upon adopting this statement, we have discontinued amortizing our license acquisition costs related to our acquisition of worldwide, royalty-bearing licenses to specified rights relating to the CorRestore System and related products and accessories because we believe these licenses have an indefinite life, and

- a \$33,000 decrease in salaries, wages, commissions and related expenses, primarily as a result of a reduction in the number of employees, principally sales and marketing (from an average of 33 employees for the second quarter of fiscal 2001 to an average of 28 employees for the second quarter of fiscal 2002).

These decreases were partially offset by

- a \$92,000 increase in commissions paid to our independent sales representatives,
- \$63,000 in customer education expenses for the CorRestore System, and
- a \$39,000 increase in professional services, primarily due to the timing of our annual meeting of shareholders.

For the three-month period ended May 31, 2002, we realized a 54% decrease in our net loss over the same period in fiscal 2001. The decrease is primarily attributable to

- a 32% increase in net revenues, and
- a 10% decrease in operating expenses.

We currently expect our fiscal 2002 net loss will be approximately \$1,000,000 to \$1,250,000.

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SOMANETICS CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

MAY 31, 2002

SIX MONTHS ENDED MAY 31, 2002 COMPARED TO SIX MONTHS ENDED MAY 31, 2001

Our net revenues increased approximately \$552,000, or 20%, from \$2,699,006 in the six-month period ended May 31, 2001 to \$3,251,426 in the six-month period ended May 31, 2002. The increase in net revenues is primarily attributable to

- An increase in United States sales of approximately \$532,000, from approximately \$1,981,000 in the first two quarters of fiscal 2001 to approximately \$2,513,000 in the first two quarters of fiscal 2002. This increase is primarily attributable to a 57% increase in sales of the disposable SomaSensor and approximately \$96,000 in CorRestore System revenue, partially offset by a 44% decrease in sales of the Cerebral Oximeter primarily as a result of approximately \$180,000 in stocking orders to independent representatives in fiscal 2001,
- a 12% increase in the average selling price of SomaSensors

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primarily due to the 25% increase in the suggested retail price of the SomaSensor in the United States effective September 1, 2001, and

- an increase in international sales of approximately \$21,000, from approximately \$717,000 in the first two quarters of fiscal 2001 to approximately \$738,000 in the first two quarters of fiscal 2002.

Sales of our products as a percentage of net revenues were as follows:

PRODUCT -----	PERCENT OF NET REVENUE	
	FIRST TWO QUARTERS OF FISCAL 2002 -----	2001 -----
SomaSensors.....	71%	55%
Model 4100 Cerebral Oximeters.....	14%	30%
Model 5100 Cerebral Oximeters.....	12%	15%
CorRestore Systems.....	3%	0%
	-----	-----
Total.....	100%	100%
	=====	=====

Approximately 23% of our net revenues in the first two quarters of fiscal 2002 were export sales, compared to approximately 27% of our net revenues in the first two quarters of fiscal 2001. One international distributor accounted for approximately 12% of net revenues for the six months ended May 31, 2002, and one international distributor accounted for approximately 13% of net revenues for the six months ended May 31, 2001.

Gross margin as a percentage of net revenues was approximately 68% for the six months ended May 31, 2002 and approximately 62% for the six months ended May 31, 2001. The increase in gross margin as a percentage of net revenues is primarily attributable to the increase in the average selling price of SomaSensors described above, and increased sales of our latest model SomaSensor, which is less costly to manufacture.

Our research, development and engineering expenses decreased approximately \$119,000, or 30%, from \$402,104 for the six months ended May 31, 2001 to \$283,442 for the six months ended May 31, 2002. The decrease is primarily attributable to approximately \$95,000 in decreased costs associated with the development of the CorRestore System, and a \$35,000 decrease in engineering salaries as a result of one less engineer.

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SOMANETICS CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

MAY 31, 2002

Selling, general and administrative expenses decreased approximately \$151,000, or 5%, from \$2,851,677 for the six months ended May 31, 2001 to \$2,701,007 for the six months ended May 31, 2002. The decrease in selling, general and administrative expense is primarily attributable to

- a \$200,000 termination fee paid in fiscal 2001 related to the

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- Kingsbridge Capital Limited Private Equity Line,
- a \$178,000 decrease in salaries, wages, commissions and related expenses, primarily as a result of a reduction in the number of employees, principally sales and marketing (from an average of 34 employees for the six months ended May 31, 2001 to an average of 28 employees for the six months ended May 31, 2002),
- a \$110,000 decrease in intangible amortization expense as a result of discontinued amortization of license acquisition costs, as described above, and
- \$45,000 paid in fiscal 2001 in connection with the Loan and Security Agreement with Crestmark Bank.

These decreases were partially offset by

- a \$205,000 increase in commissions paid to our independent sales representatives,
- an \$84,000 increase in auditing and tax service fees, primarily due to the timing of these expenses,
- \$68,000 in customer education expenses for the CorRestore System, and
- a \$38,000 increase in insurance expense, primarily due to increased products liability insurance coverage since we began marketing the CorRestore System.

For the six-month period ended May 31, 2002, we realized a 52% decrease in our net loss over the same period in fiscal 2001. The decrease is primarily attributable to

- a 20% increase in net revenues,
- a 6% increase in gross margin percentage, and
- an 8% decrease in operating expenses.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operations during the six-month period ended May 31, 2002 was approximately \$648,000. Cash was used primarily to

- fund our net loss, primarily selling, general and administrative expenses and research, development and engineering expenses, totaling approximately \$635,000, before depreciation and amortization expense, and
- increase inventories by approximately \$332,000, primarily due to purchases of CorRestore System inventory.

These uses of cash were partially offset by

- a decrease in accounts receivable of approximately \$295,000, primarily due to lower second quarter 2002 sales than fourth quarter 2001 sales, and
- an increase in accrued liabilities of approximately \$41,000, primarily due to accrued incentive compensation.

SOMANETICS CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

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MAY 31, 2002

We expect our working capital requirements to increase if sales increase.

Capital expenditures in the first six months of fiscal 2002 were approximately \$168,000. These expenditures were

- approximately \$62,000 for a display booth and exhibit to be used at industry trade shows,
- approximately \$52,000 for model 4100 and model 5100 Cerebral Oximeters being used as demonstration units,
- approximately \$35,000 in tooling costs associated with the CorRestore System, and
- approximately \$19,000 in computer equipment.

On January 16, 2002, we completed the public offering of 1,000,000 newly-issued common shares at a price of \$4.25 per share, for gross proceeds of \$4,250,000. Our net proceeds, after deducting the placement agent's commission and the expenses of the offering, were approximately \$3,680,000. Brean Murray & Co., Inc. was our exclusive placement agent for the offering and received for its services (1) \$340,000 as a placement agent fee, and (2) warrants to purchase 100,000 common shares at \$5.10 per share exercisable during the four-year period beginning January 11, 2003. A. Brean Murray, one of our directors, and his wife control Brean Murray & Co., Inc.

We have a Loan and Security Agreement with Crestmark Bank for a working capital line of credit for up to \$750,000, collateralized by all of our assets. Under the agreement, Crestmark Bank may, but is not obligated to, lend us amounts we request from time to time, up to \$750,000, if no default exists. The loans are limited by a borrowing base based on qualifying accounts receivable and lender reserves. The loan is payable on demand, and our collections of our receivables are directed to Crestmark Bank in payment of any outstanding balance of the loan. The principal amount outstanding bears interest, payable monthly, at the prime rate (4.75% as July 2, 2002) plus 2% plus a 2.4% service fee. As of July 2, 2002, we had no outstanding principal loan balance and \$657,432 was available for borrowing, at Crestmark's discretion, under the facility.

As of May 31, 2002, we had working capital of \$4,625,563, cash and cash equivalents of \$3,041,229, total current liabilities of \$606,708 and shareholder's equity of \$5,960,990.

We believe that the cash and cash equivalents on hand at May 31, 2002, together with the estimated net borrowings available under the Crestmark Bank Loan and Security Agreement, will be adequate to satisfy our operating and capital requirements for more than the next twelve months.

The estimated length of time current cash, cash equivalents and available borrowings will sustain our operations is based on estimates and assumptions we have made. These estimates and assumptions are subject to change as a result of actual experience. Actual capital requirements necessary to market the Cerebral Oximeter and SomaSensor, to develop and market the CorRestore System, to undertake other product development activities, and for working capital might be substantially greater than current estimates.

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CONDITION AND RESULTS OF OPERATIONS

MAY 31, 2002

CRITICAL ACCOUNTING POLICIES

We believe our most significant accounting policies relate to the recording of an intangible asset for license acquisition costs related to our acquisition of worldwide, royalty-bearing licenses to specified rights relating to the CorRestore System and related products and accessories, and our accounting treatment of stock options issued to employees.

We have recorded an intangible asset related to our acquisition of worldwide, royalty-bearing licenses to specified rights relating to the CorRestore System and related products and accessories. License acquisition costs include our estimate of the fair value of ten-year vested stock options to purchase common shares granted to one of our directors in connection with negotiating and assisting us in completing the transaction, and our estimate of the fair value of the vested portion of five-year warrants to purchase common shares issued in the transaction.

We estimated the value of the stock options to purchase common shares and the warrants to purchase common shares using the Black-Scholes valuation model. The Black-Scholes valuation model requires the following assumptions: expected life period of the security, expected volatility of our stock price during the period, risk-free interest rate, and dividend yield. Given the assumptions inherent in the Black-Scholes valuation model, it is possible to calculate a different value for our intangible asset by changing one or more of the valuation model variables or by using a different valuation model. However, we believe that the model is appropriate, that the judgements and assumptions that we have made at the time of valuation were also appropriate, and that the reported results would not be materially different had one or more of the variables been different or had a different valuation model been used.

In addition, effective December 1, 2001, we adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets." The effect of adopting this Statement has been to discontinue amortizing our license acquisition costs related to our acquisition of worldwide, royalty-bearing licenses to specified rights relating to the CorRestore System and related products and accessories described above because we believe these licenses have an indefinite life. For the first two quarters of fiscal 2001, we incurred amortization expense of approximately \$110,000 associated with these license acquisition costs. Our net loss for the six months ended May 31, 2001, excluding the effect of amortizing our license acquisition costs, would have been approximately \$1,451,000, or \$(.20) per common share.

In October 1995, Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," was issued by the Financial Accounting Standards Board. We have chosen to continue to account for stock-based compensation of employees using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, compensation costs for stock options granted to employees are measured as the excess, if any, of the market price of our stock at the date of the grant over the amount an employee must pay to acquire the stock. No compensation expense has been charged against income for stock option grants to employees because our stock option grants are priced at the market value as of the date of grant. During the first two quarters of fiscal 2002, we granted 388,500 stock options to our employees. Had we recognized compensation expense for these stock options, based on the fair value of the options on the grant date using the Black-Scholes valuation model, our net loss for the six months ended May 31, 2002, on a pro forma basis, would have increased by approximately \$774,000, or \$.09 per common share. Had we

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recognized compensation expense for our stock options granted to employees in fiscal 2001, based on the fair value of the options on the grant date using the Black-Scholes valuation model, our net loss on a pro forma basis would have increased by approximately \$752,000, or \$.10 per common share.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

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PART II OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

Our Annual Meeting of Shareholders was held on April 17, 2002. At the Annual Meeting, Daniel S. Follis, Dr. James I. Ausman and Joe B. Wolfe were elected as directors and the terms of office of Bruce J. Barrett, A. Brean Murray, H. Raymond Wallace and Robert R. Henry as directors continued after the meeting. 8,096,359 votes were cast for Mr. Follis' election and 73,445 votes were withheld from Mr. Follis' election, 8,112,959 votes were cast for Dr. Ausman's election and 56,845 votes were withheld from Dr. Ausman's election, and 8,092,334 votes were cast for Mr. Wolfe's election and 77,470 votes were withheld from Mr. Wolfe's election. There were no abstentions or broker non-votes in connection with the election of the directors at the Annual Meeting.

In addition, at the Annual Meeting of Shareholders, the shareholders approved an amendment to the Somanetics Corporation 1997 Stock Option Plan to increase the number of common shares reserved for issuance pursuant to the exercise of options granted under the 1997 Plan by 450,000 shares, from 1,660,000 to 2,110,000 shares. 7,498,863 votes were cast in favor of this proposal, 650,802 votes were cast against this proposal, and 20,139 votes abstained on this proposal. There were no broker non-votes in connection with the amendment to the 1997 Stock Option plan at the Annual Meeting.

In addition, at the Annual Meeting of Shareholders, the shareholders approved the issuance and sale on April 9, 2001 of 100,000 common shares at \$1.75 a share to Robert R. Henry, one of our directors, and 32,285 common shares at \$1.75 a share to the Brean Murray & Co., Inc. Profit Sharing Plan, an entity affiliated with A. Brean Murray, one of our directors, all pursuant to Nasdaq Rule 4350(i)(1)(A). 2,333,046 votes were cast in favor of this proposal, 449,231 votes were cast against this proposal, and 39,608 votes abstained on this proposal. There were 5,347,919 broker non-votes in connection with this proposal at the Annual Meeting.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

None.

(b) Reports on Form 8-K

No reports on Form 8-K were filed by us during the quarter for

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which this report is filed.

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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.

Somanetics Corporation

(Registrant)

Date: July 10, 2002

By:/s/ William M. Iacona

William M. Iacona
Vice President, Finance, Controller, and
Treasurer (Duly Authorized and Principal
Financial Officer)

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