

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

EYE DYNAMICS INC
Form 10KSB
April 06, 2005

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

FORM 10-KSB

(X) Annual Report under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2004

EYE DYNAMICS, INC.

(Name of small business issuer in its charter)

Nevada

88-0249812

(State or other jurisdiction
of incorporation)

(I.R.S. Employer Identification Number)

2301 W. 205th Street, #102

Torrance, CA 90501

(Address of principal executive offices)

(City, state and ZIP)

Issuer's telephone number 310-328-0477

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock Par Value \$.001 per share

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 (X) Yes () No.

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB (X)

State issuer's revenues for its most recent fiscal year: \$2,084,538

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as a specified date within the past 60 days: \$4,775,335 as of February 15, 2005

The number of shares outstanding of the issuer's common stock as of February 15, 2005 was 17,883,081.

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

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

PART 1

ITEM 1. DESCRIPTION OF BUSINESS

GENERAL

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

INTRODUCTION

The human eye is a very sensitive organ. Eye movements or pupil reactions are excellent indicators of the presence of disease, drugs or other conditions which may impair the human ocular motor system. In particular, the Company's technology deals with the central nervous system condition of nystagmus, a rapid, involuntary oscillation of the eyeball. Nystagmus occurs in different forms and has a number of causes, ranging from the serious (e.g., a tumor in the brain or ear) to the benign (such as positional dizziness). The consumption of certain drugs and alcohol also causes nystagmus, and there is a direct and quantifiable correlation between blood alcohol concentration in the body and the angle of onset of nystagmus. Medical research conducted over the past fifty years has furnished evidence demonstrating a relationship between irregular eye movement and abnormal central nervous system physiology. The causes of these conditions are numerous, and include the influences of alcohol, drugs, illness, stress, extreme fatigue and other neurological conditions

The basic technology used in all of the Company's products is similar, yet differs in its application and use. The Company's products utilize infrared sensitive video cameras to monitor, videotape and analyze eye performance and movement. All the products share in a modular concept for efficiency in manufacturing. The products are PC computer based with specialized and proprietary hardware and embedded firmware. A common element of the products is the Ocular Motor Module, where the subject being tested peers into a dark environment. The products include an infrared sensitive Charge Coupled Device video camera that provides a bright video image, even though the person being tested sees nothing but a small stimulus or tracking light amid complete darkness.

PRODUCTS

MEDICAL PRODUCTS. Eletronystagmographic (ENG) testing is a standard medical procedure used in assessing problems of the balance system of patients. This method provides enhanced diagnostic information for the medical practitioner to use for the final diagnosis of the patient's problem. Testing of patients for irregular eye movements has been a standard medical procedure for several decades. For this market, the Company markets the House InfraRed/Video ENG System. The ENG System is the first major technological improvement in this standard medical testing method in the past forty years. The Company's products have gained a share of this highly specialized market. The FDA granted approval

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

to market this product in 1994.

Irregular eye movements and conditions are analyzed by medical specialists as an aid in diagnosing problems with the human balance system and other neurological conditions. In the past, diagnostic products have used "electrodes" that are taped to the skin around the periphery of the patient's eyes and a very small electrical signal from the corneo-retinal potential of the eyes drives a pen recorder. The pen recorder provides a graphical depiction of the eye movements under different test conditions. These graphs are then interpreted by the medical diagnostician.

2

The Company brought the use of infrared illumination of the eyes into clinical use in 1994 when the U.S. Food and Drug Administration ("FDA") approved marketing of its House InfraRed/Video ENG System. This device was the first to replace the electrodes with infrared sensitive video cameras and with computer digital processing that follows the movement of the eyes and graphically portrays the movements much like the pen recorder. The test subject wears a lightweight goggle assembly which uses micro-miniature video cameras. The goggle is an essential instrument because certain of the ENG tests require the patient to move his head and often to recline on an examining table. The Company believes the accuracy and display of the Infrared/Video ENG System represents a significant improvement over other existing testing methods. In addition, the use of video by the Infrared/Video ENG System allows the test administrator or medical practitioner to observe the eye movements directly and can provide a videotape record of the test for later playback and additional analysis. The Company believes that this is a significant improvement over prior technology. This product was first marketed in 1994, after gaining FDA approval to market. Since then most every competitor has changed from electrodes and is embracing video data acquisition as a superior technology. Results from the tests are used by physicians and clinicians.

The computer-based system, with proprietary Eye Position Interface Controller, "locks" on to the pupils and independently tracks the horizontal and vertical movements of each eye. The nystagmus is displayed in real time, saved, analyzed and printed. The four channel system comes with a 12" Quad/Video Monitor that displays both eyes on a single video screen.

The system was developed by the Company in conjunction with the House Ear Clinic and House Ear Institute, Los Angeles, California. The "House" name is used with the permission of the House Ear Institute.

IMPAIRMENT DETECTION PRODUCTS. The Company's impairment detection product, SafetyScope (previously known as the "EPS-100"), allows employers and others to screen individuals for physiological signs of impairment. The system evaluates involuntary changes in eye movements and/or pupil reactions, which may result from drug or alcohol abuse, reactions to medication, medical conditions, stress or fatigue. Occupations in the medical, aviation, emergency response, manufacturing and transportation businesses are key markets for this technology. Unlike most drug and alcohol test methods, the SafetyScope functions without the need for body fluids. Also, due to its less invasive nature, SafetyScope only reveals if a person is impaired at the time of the test and does not test for past use. Also, unlike blood and urine tests which only measure the presence of a substance in the body, the SafetyScope only takes into account the physiological effects of the substance.

While substance abuse receives the most attention, worker impairment

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

caused by other factors, such as prescription and over-the-counter medications, stress, extreme fatigue and illness, is a significant expense to employers. Workers suffering from such impairments are characterized by low productivity, more accidents, higher workers' compensation and insurance costs, and equipment and merchandise damage. Different types of performance tests have evolved based on extensive scientific studies validating the relationship between test results and the impaired performance of an individual. They assess an individual's motor and cognitive skills at the time of the test.

The SafetyScope is based on methods developed by the federal government and used by law enforcement over the past 30 years. The SafetyScope is a simple computer system that evaluates the ability of an individual's eyes to follow a moving light and react to a dim and bright light stimulus. The SafetyScope is non-diagnostic and non-judgmental; it evaluates performance of the individual solely for safety and productivity purposes. The preferred pricing model is to place the units with the user at no initial cost, except for a modest deposit, and to charge the user a fee for each test administered. It is anticipated that the fees for such tests will range from \$1 to \$5 per test, depending on the monthly quantity of tests, with an average of approximately \$3 per test.

3

An employee looks into the SafetyScope and focuses on a moving beam of light. A video camera records the action, and software analyzes eye movement (smooth or jerky) and pupil reaction (small or large) and renders a determination on whether there is impairment. In just ninety seconds, the SafetyScope tests the human eye for the purpose of evaluating an individual for impairment, by measuring twenty parameters of eye movement and pupil change, relating to the position and reaction time of the eye and the size of pupil. The SafetyScope reports the result of the test instantly with a "Pass" or "Fail" result. The system does not require bodily fluids such as blood or urine. SafetyScope offers users major advantages over traditional drug tests, in that the system can detect on-the-spot impairment and results are immediate. Designed for workplace testing, it can be utilized in a random testing or regular scheduled testing environment. Traditional drug tests can take days to complete, which is too late for detecting a problem the day it occurs.

SafetyScope can be an important component for evaluating an employee for job safety, particularly those jobs in life-dependent occupations, such as airline pilots, bus drivers, train engineers, firefighters, medical personnel, construction workers and law enforcement personnel, among others. Companies and government agencies around the world are evaluating this cost-effective technology to replace traditional drug tests that require body fluids and are much more expensive to conduct.

Even in healthy subjects the eyeball exhibits rapid, involuntary, oscillatory movements, a phenomenon called nystagmus. But, as the subject's brain function becomes increasingly impaired these movements become more and more erratic. The SafetyScope uses an algorithm developed through thousands of trials with hundreds of people under the influence of alcohol, heroin, marijuana, and cocaine. The trials compared their current reading with a baseline reading taken prior to being dosed with the substance.

The Company believes that the SafetyScope will be especially useful for applications where fatigue in the workplace has an impairing effect on workers. The Company contracted with a major human alertness technology consulting and research organization to optimize the SafetyScope for fatigueness testing. The Company believes the SafetyScope will appeal to employers with round-the-clock

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

workforces who desire to reduce industrial accidents caused by employee fatigue and to improve worker alertness and safety. It is estimated that in our society more than 20 million Americans, or over 10% of the workforce, work outside of normal daylight working hours, which tends to increase the effect of extreme fatigue.

The Company also offers a second model, the EM/1, which is designed for use by law enforcement agencies for forensic purposes and for the evaluation of individuals suspected of driving or being under the influence of intoxicants. The EM/1 functions in a manner similar to the SafetyScope, but without the "Pass/Fail" result. Instead, the EM/1 delivers the videotaped data for interpretation by the law enforcement agency.

In most states, law enforcement agencies use a six point evaluation of people thought to be intoxicated. This is referred to as the Standardized Field Sobriety Test ("SFST"). The SFST includes three tests for balance and three tests involving eye performance. Thus, the Company believes there is a need for a product that can be utilized, not only in the jail or precinct house, but in the field by traffic patrol cars. This product must ultimately be in a 'hand held' configuration.

Hardware for the EM/1 is similar to the SafetyScope, but different operating software requires that a person trained and certified in SFST and drug recognition and evaluation operate the equipment and evaluate eye performance. From the EM/1 test results and other test information, the evaluator draws an opinion as to whether the individual is impaired and under the influence of intoxicants or not, or whether medical treatment is indicated. The video tape made of the test is then available as evidence to support the conclusion of the law enforcement officer and, depending on the jurisdiction, may be admissible as evidence in court proceedings. The EM/1 is currently priced at \$14,000 per unit; however, the Company plans to introduce a handheld unit within the next two years, which should sell for less than \$5,000.

4

MARKETING

MEDICAL PRODUCTS. Marketing of the Infrared/Video ENG System is conducted through an exclusive master distributor who has a network of independently owned sub-distributors, known as special instrument dealers. These independently owned businesses are distributors of not only the IR/Video ENG System, but of a variety of allied and related products for the audiometric and otolaryngology ("ENT") markets. These distributors are across the United States and operate in territories that are assigned both exclusively and non-exclusively to them by the master distributor. In addition, there are several foreign distributors that are merchandising the product in countries such as India, Egypt, Hungary, Turkey, Thailand, Taiwan and Korea. The Company is not yet selling in the European Community countries due to lack of the "CE" mark of approval that must be obtained prior to marketing in those countries.

The Company has also supplied a modified version of the Infrared/Video ENG System to two distributors on a private label basis. These private label sales have represented a significant portion of sales of the product. Sales to this private label distributor accounted for 62% of the total sales for the year 2004.

The market for the ENG products is relatively mature and represents only annual growth estimated at 5%, but because of the advancement of technology

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

spurred by the Company's introduction of video data acquisition methods in 1994, the market for replacement products has been strong. Also, there has been considerable effort to open new markets for our products, including the neurology market, through our private label distributor and through mobile diagnostic providers of testing services.

The Company contemplates that new versions of the ENG product will be marketed through an arrangement with MedTrak Technologies, our master distributor. It will market new "Eye Dynamics" branded products to an expanded array of medical specialty markets. The Company has appointed MedTrak as "Master Distributor" for these products.

IMPAIRMENT DETECTION PRODUCTS. The Company has been test marketing the SafetyScope and has sold a few units in various locales. Currently, independent sales representatives are being recruited to achieve geographic distribution coverage over the United States. However, implementation of a full marketing plan is contingent on receipt of additional working capital.

In general, government drug testing regulations are based on urine Testing, so testing of employees by governmental agencies, quasi-governmental agencies and certain regulated industries must comply with these regulations. Accordingly, some modification of these regulations must be achieved in order for the SafetyScope to gain broad acceptance in this sector. Companies that do substantial business with government agencies often must have a drug testing program that complies with government regulations. Also, industries that are regulated by the Department of Transportation must comply with these regulations, as well as certain other industries regulated by the federal government, such as the nuclear power industry.

These factors limit the overall size of the market currently available to the Company to private companies that are not regulated by the federal government with respect to testing employees for substance abuse. If a private employer falls within government regulated drug testing requirements, but desires to also use impairment testing methodologies, it must do so in addition to the government regulation requirements. This creates an additional cost to such testing and therefore greatly limits the Company's access to that market.

The Company has conducted discussions with various government agencies to modify applicable regulations and procedures so that they will encompass testing based on eye movement and performance. While certain governmental agencies have expressed an interest in the Company's products, management believes that changing governmental testing regulations will be a lengthy process and success is not assured.

COMPETITION

MEDICAL PRODUCTS. The principal competitors in the medical market making ENG testing equipment are MicroMedical Technologies, Inc., ICS Medical Corporation and Interacoustics. Since the Company's ENG product was introduced in 1994, competitors have developed similar video-based ENG goggle products. As a result, the market has become very competitive and subject to pricing pressures. As a consequence, the Company has reduced prices, with an adverse effect on overall gross margins. To combat this competitive pressure the Company has reduced manufacturing costs in an effort to offset the gross margin loss. Also, the gross profit on sales to the private label distributor is less than sales of our own branded products.

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

IMPAIRMENT DETECTION PRODUCTS. Competition for the SafetyScope is from companies that have developed tests and devices that evaluate motor and cognitive skills. These take the form of hand-eye coordination tests, divided attention tests and other behavioral tests or series of tests administered either in series or selectively. The Company has identified three such competitors that have marketed these products in the past, including Performance Factors, Inc., Essex Corporation, and Pulse Medical Instruments.

The Company believes only Pulse Medical Instruments is developing a product to be directly competitive with the Company's products. The Pulse Medical product does not use video sensors and its results are displayed in graphic form on a computer monitor for the qualified expert to interpret. The Company believes that such product will be more expensive than the SafetyScope and is still under development and validation as a useful device.

The SafetyScope differs from its competitors' tests because the SafetyScope test evaluates changes in eye performance, which are involuntary responses and not under the control of the individual. For this reason, these responses cannot be changed, improved upon or learned. All the other competitive forms of performance tests known to the Company can be learned and over time the individual being tested can improve his skills. The Company believes that this difference is an important competitive advantage over other forms of performance tests.

The SafetyScope also competes with drug and alcohol abuse test kits and devices, which principally rely on collection and testing of urine samples. In addition, certain drug and alcohol abuse tests now being developed will test saliva and/or hair for evidence of the presence of certain drugs or alcohol. The principal advantages of the SafetyScope over others tests are the immediacy of results and the non-invasive nature of the procedure. The Company believes that the potential for safety improvement that the SafetyScope will provide for life-dependent professions, such as airline pilots, bus drivers and train engineers, will make the system a very important breakthrough for public safety in these fields.

MANUFACTURING

The Company has performed all its own design and engineering of products and has developed all software and validation of software algorithms that are used in the analysis portion of the proprietary software.

Manufacturing of both the ENG products and the SafetyScope is primarily done through subcontracting with various suppliers. The Company does not rely on a single supplier for the major manufacturing of items. Various companies build and test product modules on an OEM contract basis. Final system integration and testing is completed by the Company prior to shipment of devices to customers. All the products share in a modular concept for efficiency in manufacturing. The products are PC Computer based with specialized and proprietary hardware and embedded firmware. The common elements of the products are the viewport and the goggles, through which the individual being tested peers into a dark environment.

Manufactured or fabricated modules include the molded eye piece, the goggle assembly, the viewport assembly and proprietary printed circuit boards. As a majority of the components in the Company's products are readily available, the Company does not anticipate undertaking internal manufacturing of any components. Manufacturing operations consist of only assembly, testing and packaging functions.

GOVERNMENT REGULATION

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

The Company's ENG products have been approved for marketing by the U.S. Food and Drug Administration. The Company is also licensed by the State of California as a Medical Device Manufacturer. The SafetyScope and EM/1 are not subject to regulation, as they are not considered medical devices. However, as discussed above under the caption "Marketing," governmental regulations on substance abuse testing for government employees and certain private companies impact the Company's ability to market the SafetyScope in these areas.

PATENTS & PROPRIETARY PROTECTION

The Company licenses the technology used in its performance evaluation products from Ronald A. Waldorf, Chairman of the Board of Directors and Chief Executive Officer, who holds a patent covering claims relating to tracking eye movements in the dark, utilizing infrared illumination and infrared sensitive video cameras, as well as the related analysis methodology. The patent was issued in 1989 and expires in 2006. The license is for the term of the underlying patent, and calls for nominal annual royalties of \$100.

6

The Company is the owner of a patent issued in August 1992, covering certain technology underlying the SafetyScope, principally relating to the apparatus for testing for impairment by tracking eye movements and pupil reactions to presented stimuli.

The existence of patents may be important to the Company's future operations, but there is no assurance that additional patents will be issued. For both of the above named patents, eleven foreign patents have been issued and/or are pending in several foreign countries.

The Company also relies on unpatented technology, know-how and trade secrets covering a number of items, particularly the methods of obtaining data regarding eye performance. The Company relies on confidentiality agreements and internal procedures to protect such information.

EMPLOYEES

The Company employs five employees full time, including its President, a development engineer, an export marketing manager and technical support person plus an administrative person. Other part time consulting and commissioned personnel are also utilized. The Company's employees are not parties to any collective bargaining agreement, and the Company believes that its employee relations are satisfactory.

ITEM 2. DESCRIPTION OF PROPERTY

The Company's offices are in leased space in an industrial complex in Torrance, California. The offices occupy 1620 square feet and the lease expires on January 31, 2006. The current monthly lease payment is \$1,685.

ITEM 3. LEGAL PROCEEDINGS

Inapplicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Inapplicable

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

PART II

ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES.

The following table sets forth the quarterly high and low closing prices for the Common Stock, as reported on the OTC Bulletin Board, during the 2004 and 2003 fiscal years.

	LOW	HIGH
	---	----
2004		

First Quarter	\$.42	\$.79
Second Quarter	.37	.85
Third Quarter	.14	.39
Fourth Quarter	.13	.18
2003		

First Quarter	.045	.11
Second Quarter	.05	.35
Third Quarter	.14	.25
Fourth Quarter	.205	.75

The Company's common stock is traded on the OTC Bulletin Board under the symbol "EYDY". As of December 31, 2004, the Company's Common Stock was held of record by approximately 111 holders. Registered ownership includes nominees who may hold securities on behalf of multiple beneficial owners.

The Company has paid no cash dividends on its Common Stock and has no present intention of paying cash dividends in the foreseeable future.

7

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

The following discussion and analysis should be read in conjunction with the Company's Consolidated Financial Statements and Notes thereto included elsewhere in this Annual Report on Form 10-KSB. Except for the historical information contained herein, the following discussion contains certain forward-looking statements that involve risks and uncertainties, such as statements of the Company's plans, objectives, expectations and intentions. The cautionary statements made in this Annual Report on Form 10-KSB should be read as being applicable to all related forward-looking statements wherever they appear in this Annual Report on Form 10-KSB. The Company's actual results may differ materially from the results discussed in the forward-looking statements as a result of certain factors including, but not limited to, those discussed elsewhere in this Annual Report on Form 10-KSB.

The Company has invested substantial funds in the last several years developing and validating its products. The Company is successfully producing and marketing the Infrared/Video ENG System; however, since this is a niche product in a relatively mature market, potential revenue growth from this product line is limited. To date, sales of this product have constituted a substantial portion of the Company's revenues.

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

The SafetyScope product and its predecessor, the EPS-100 Performance System, has been sold in a few locales and beta marketing has been successful. However, for large scale marketing and sales of this product, the Company will need a substantial infusion of capital, as well as modification of federal drug testing regulations. This is a significant project, requiring a coordinated effort with potential customers, government officials, and legislators. Therefore, additional investment capital will be is required to launch the marketing of the SafetyScope, and a large scale marketing and lobbying effort will be necessary for the product to succeed. A business plan has been prepared for commercialization of the SafetyScope and is being evaluated by interested parties.

RESULTS OF OPERATIONS

Year Ended December 31, 2004 Compared to Year Ended December 31, 2003.

Revenues from sales of products decreased by 35%, from \$3,238,282 in 2003 to \$2,084,538 in 2004. This decrease is largely due to a slowdown in product sales due to a suspension of reimbursements to medical providers by Medicare for several months while the agency evaluated the medical providers and increased the quality requirements for the technicians performing tests. This resulted in potential new customers delaying purchases of new capital equipment until the technician training situation was resolved. In addition, issues had been raised about tests being performed by testing centers where no 'medical necessity' had been established and/or physician referral obtained. This was not an issue relating to Eye Dynamics equipment, but rather an issue of the practices utilized by the testing centers. These issues have been largely resolved, and Medicare resumed payments shortly thereafter. However, product purchase levels have not yet returned to the volume of 2003. Our private label distributor accounted for approximately 53% of our sales revenues in 2003, and in 2004 accounted for 62%. In November we appointed the Private Label distributor as 'Master Distributor' to market all the Eye Dynamics branded models of ENG equipment, as well as its private brand items. Gross profit percentage remained stable in 2004 at 49%, compared to 52% in 2003, which is a reflection of the higher percent of sales to the private label distributor. Gross profit in 2004 of \$1,030,986 was attained with a net profit of \$386,315 for the year. Gross profit in 2003 was \$1,668,726, with a net profit of \$1,043,027.

Inventory turnover ratio in 2004 was approximately 6:1, compared to 6:1 in 2003. This is a reflection of the decrease in business and also indicates the reduction of products in inventory to match the lesser sales level of 2004.

Collection of accounts receivables has been very satisfactory, with only minimal slow paying accounts. Our private label account ordinarily pays invoices within fifteen days of the invoice date. Bad debt write off for 2004 was \$1,669.

Product development is limited due to resources available and is concentrated on software and current product improvements that will make the existing products more competitive and desirable.

On March 24, 2005, the company announced the execution of a Letter of Intent to acquire OrthoNetx, Inc., a leading provider of medical devices for osteoplastic surgery. OrthoNetx is located in Superior, Colorado. It is contemplated that the transaction, when completed, will be a stock transaction in which OrthoNetx shareholders will receive one share of Eye Dynamics Stock in

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

exchange for each share of OrthoNetx stock. The acquisition is subject to certain customary conditions, including regulatory approvals.

LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2004, the Company had an accumulated deficit of approximately \$2,248,571. As of that date, the Company had \$847,235 in cash, approximately \$44,492 in net accounts receivable, and \$180,708 in inventory. Also, the Company had \$53,695 of current liabilities, consisting of accounts Payable and accrued liabilities. Long term liabilities consist solely of a note balance of \$40,000, which, at the note holder's option, may be converted into common shares of the company.

The Company has no plans for significant capital equipment expenditures for the foreseeable future.

The Company believes that current and future available capital resources, cash flow from operations and other existing sources of liquidity will be adequate to fund its operations. However, there can be no assurance that sufficient funds will be available or that future events will not cause the Company to seek additional capital sooner. To the extent the Company is in need of any additional financing, there can be no assurance that any additional financing will be available to the Company on acceptable terms, or at all. The inability to obtain such financing could have a material adverse effect on the Company's business, financial condition and results of operations. If additional funds are raised by issuing equity or convertible debt securities, options or warrants, further dilution to the existing shareholders may result.

If adequate funds are not available, the Company may also be required to delay, scale back or eliminate its product development efforts or to obtain funds through arrangements with strategic partners or others that may require the Company to relinquish rights to certain of its technologies or potential products or other assets. Accordingly, the inability to obtain such financing could result in a significant loss of ownership and/or control of its proprietary technology and other important Company assets and could also adversely affect the Company's ability to continue its product development efforts, which the Company believes contributes significantly to its competitive advantage. If any of such circumstances were to arise, the Company's business, financial condition and results of operations could be materially and adversely affected.

EFFECT OF INFLATION

The Company believes that inflation has not had a material effect on its net sales or profitability in recent years.

ITEM 7. FINANCIAL STATEMENTS

The financial statements of the Company are submitted as a separate section of this Annual Report on Form 10-KSB, commencing with page F-1.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 8A. CONTROLS AND PROCEDURES

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

The Company's chief executive officer and chief financial officer, after evaluating the effectiveness of its disclosure controls and procedures as of the end of the year covered by this report (the "Evaluation Date"), as required by Exchange Act Rule 13a-15, concluded that the Company's disclosure controls and procedures were effective and designed to ensure that material information relating to the Company is accumulated and would be made known to them by others within the Company as appropriate to allow timely decisions regarding required disclosures.

There were no significant changes in the Company's internal controls over financial reporting that occurred during the year ended December 31, 2004 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

The Company's management believes that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company will be detected.

ITEM 8B. OTHER INFORMATION

Inapplicable

PART III

ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The directors and executive officers of the Company are as follows:

NAME ----	AGE ---	POSITION -----	DIRECTOR SINCE -----
Ronald A. Waldorf	56	Chief Executive Officer, Secretary & Director	1991
Charles E. Phillips	69	President, Treasurer & Director	1991
Arnold D. Kay	69	Director	1999
Barbara J. Mauch	59	Chief Product Development Engineer	----

Directors serve for a term of one year or until the next annual meeting of shareholders.

RONALD A. WALDORF has been Chairman of the Board of Directors of the Company since 1991 and is active in overall policy formation and strategic planning for the Company. He was appointed as Chief Executive Officer in January 2005. He is the inventor of the IR/Video ENG System, SafetyScope and EM/1 products. He also owns a patent covering closely related technology that has been licensed exclusively to the Company. Since 1969 Waldorf has been active in the field of otolaryngology, primarily in an academic research environment at the University of Florida, College of Medicine and at the University of California (Irvine), Department of Surgery. He has published numerous articles on vestibular and optokinetic research in international scientific and medical journals and was the principal investigator in a research grant funded by the National Institute of Health/National Institute on Alcohol Abuse and Alcoholism(NIH/NIAAA). Since 1981 he has acted as a consultant to clinics and hospitals in the Los Angeles area, including the House Ear Clinic. He has also

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

consulted to a Japanese company developing new technologies for eye movement detection.

Mr. Waldorf earned an M.S. from the Department of Physiology of the College of Medicine, University of Florida, in 1972.

10

CHARLES E. PHILLIPS has been President and a Director of the Company and its predecessor, OculoKinetics, Inc. since its inception in 1988. Prior to forming OculoKinetics, Inc., Mr. Phillips operated Charles E. Phillips, Inc., a management and marketing consulting firm. His work has included assignments in marketing, operations and the initiation of start-up ventures. From 1974 to 1985, Mr. Phillips was Executive Vice President and Director of Akai America, Ltd., a consumer electronics company. His management background has encompassed marketing, new product planning, sales, advertising, finance, accounting, manufacturing, quality assurance and distribution.

Mr. Phillips received a B.A. from Pepperdine College, Los Angeles, California with emphasis on Business and Speech Education, in 1956.

ARNOLD D. KAY was elected a Director in September 1999. He has more than thirty years experience in finance, sales and administration. Mr. Kay was an employee of the Company from 1991 to 1994. He currently is co-owner and General Manager of Lomita Blueprint/CADWEST of Lomita, California, a software and computer imaging business focusing on design, graphics and distribution of CAD software and systems.

Mr. Kay received a B.S. in Business Administration/Finance from California State University, Northridge, in 1961.

BARBARA J. MAUCH is the primary product development engineer for the Company. She has been with the Company since 1989 and is responsible for product engineering and software development. Her background encompasses computer systems design and software development for access control of buildings and other properties. She served as a Director of the Company from 1991 to 1996.

Ms. Mauch earned a B.S. in Mathematics from Northern Colorado University in 1971 and completed the Master's program in computer science at UCLA.

DIRECTORS' COMPENSATION

The members of the Board of Directors do not receive monetary compensation for their service as directors, but are entitled to receive options to purchase 20,000 shares of common stock for each year of service. As no options had been issued under this policy since its inception in 1999, in January 2005 the Company issued the options to each director for his period of service. Thus, options to purchase up to 360,000 shares were issued, at an exercise price of \$.15 per share.

Directors are also eligible for reimbursement of their expenses incurred in connection with attendance at Board meetings in accordance with Company policy.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires the Company's officers and directors, and persons who own more than 10% of a registered class of the

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

Company's equity securities (the "10% Stockholders"), to file reports of ownership and changes of ownership with the Securities and Exchange Commission. Officers, directors and 10% Stockholders of the Company are required by Commission regulation to furnish the Company with copies of all Section 16(a) forms so filed.

Based upon a review of filings made and other information available to it, the Company believes that each of the Company's present Section 16 reporting persons filed all forms required of them by Section 16(a) during the year 2002.

ITEM 10. EXECUTIVE COMPENSATION

SUMMARY COMPENSATION TABLE

The following table sets forth certain compensation awarded or paid by the Company to its Named Executive Officers and others during the fiscal years ended December 31, 2004, 2003 and 2002.

11

SUMMARY COMPENSATION TABLE

NAME AND PRINCIPAL POSITION	YEAR	ANNUAL COMPENSATION			LONG-TERM COMPE		L PA
		SALARY \$	BONUS \$	OTHER \$	AWARDS	PAYOUTS	
					RESTRICTED STOCK AWARDS \$	OPTIONS #	
Charles E. Phillips	2004	120,000	0	0	0	0	
	2003	97,500	0	0	0	0	
	2002	76,000	0	0	0	0	
Ronald A. Waldorf	2004	0	0	0	0	0	
	2003	0	0	0	0	0	
	2002	0	0	0	0	0	
Barbara J. Mauch	2004	76,000	0	0	0	0	
	2003	67,500	0	0	0	0	
	2002	56,000	0	0	0	0	

There were no options granted or exercised in 2004.

The following table sets forth certain information concerning options outstanding at December 31, 2004:

Shares Acquired on	Value	Number of Unexercised Options at	Value of Unexercised In-the-money Options at
-----------------------	-------	--	--

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

Name	Exercise	Realized	December 31, 2003*	December 31, 2003*
----	-----	-----	-----	-----
Charles E. Phillips	0	0	0	0
Ronald Waldorf	0	0	0	0
Arnold Kay	0	0	0	0
Barbara J. Mauch	0	0	0	0

The Company has employment agreements with its President and an employee that provide for aggregate annual compensation of \$150,000. The agreements are automatically renewed year to year. The agreements may be terminated by the Company or the officers with notice 60 days prior to any expiration date.

12

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth information regarding the beneficial ownership of the Common Stock of the Company as of December 31, 2004, by (i) each person known by the Company to beneficially own 5% or more of the outstanding Common Stock of the Company; (ii) each of the Company's directors; (iii) the Named Executive Officers identified in the Summary Compensation Table; and (iv) all directors and Named Executive Officers of the Company as a group.

Name & Address	Number of Shares	Percentage Owned
-----	-----	-----
Charles E. Phillips 2301 W. 205th St., #102 Torrance, CA 90501	2,105,489	11.8
Ronald A. Waldorf 2301 W. 205th St., #102 Torrance, CA 90501	1,067,100	6.0
Barbara J. Mauch 2301 W. 205th St., #102 Torrance, CA 90501	1,382,544	7.8
Arnold D. Kay 2301 W. 205th St., #102 Torrance, CA 90501	63,128	0.4
All directors and executive officers as a group (4 persons)	4,618,261	25.8

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

above have sole voting and investment power with respect to all shares of Common Stock shown as beneficially owned by them. Shares of Common Stock subject to securities currently convertible, or convertible within 60 days after December 31, 2004, are deemed to be outstanding in calculating the percentage ownership of a person or group but are not deemed to be outstanding as to any other person or group.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The Company licenses the technology used in its performance evaluation products from Ronald A. Waldorf, Chairman of the Board of Directors and Chief Executive Officer, who holds a patent covering claims relating to tracking eye movements in the dark, utilizing infrared illumination and infrared sensitive video cameras, as well as the related analysis methodology. The patent was issued in 1989 and expires in 2006. The license is for the term of the underlying patent, and calls for nominal annual royalties of \$100.

13

ITEM 13. EXHIBITS

(A) The following exhibits are included herein or incorporated by reference:

- 3(i)* Articles of Incorporation, as amended.
- 3(ii)* Bylaws
- 10.1* Employment Agreement, dated April 1, 1989 with Charles E. Phillips
- 10.2* Employment Agreement, dated December 1, 1989 with Barbara J. Mauch
- 10.3* Exclusive Licensing Agreement, dated November 1, 1989 with Ronald A. Waldorf
- 10.4** Agreement, dated March 19, 2001 between the Company and Medtrak, Inc.
- 10.4*** Standard Multi-Tenant Commercial Industrial Lease-Gross, dated January 9, 2003, between the Company and AMB Property, L.P.
- 10.6*** Technology Development Agreement, dated November 18, 2002, between the Company and HRL Laboratories, LLC
- 10.7*** Registration Rights Agreement, dated November 18, 2002, between the Company and HRL Laboratories, LLC
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

* Incorporated by reference from Amendment No. 1 to the Registration Statement on Form 10-SB, filed on December 13, 1999.

** Incorporated by reference from Report on Form 10-K for the year ended December 31, 2000, filed on April 16, 2001.

*** Incorporated by reference from Report on Form 10-KSB for the year ended December 31, 2002, filed on April 9, 2003.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following is a summary of the fees billed to the Company by Spector & Wong, LLP, its independent certified accountants, for professional services rendered for the fiscal years ended December 31, 2004 and 2003:

Fee Category	Fiscal 2004 Fees	Fiscal 2003 Fees
Audit Fees	\$7,000	\$6,600
Audit-Related Fees	5,000	7,200
Tax Fees	1,350	1,200
All Other Fees	-0-	-0-
Total Fees	\$13,350	\$15,000

Audit Fees. Consists of fees billed for professional services rendered for the audit of the Company's consolidated financial statements and review of the interim consolidated financial statements included in quarterly reports and services that are normally provided by Spector & Wong in connection with statutory and regulatory filings or engagements.

Audit-Related Fees. Consists of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of the Company's consolidated financial statements and are not reported under "Audit Fees." There were no Audit-Related services provided in fiscal 2003 or 2002.

14

Tax Fees. Consists of fees billed for professional services for tax compliance, tax advice and tax planning.

All Other Fees. Consists of fees for products and services other than the services reported above. There were no management consulting services provided in fiscal 2004 or 2003.

POLICY ON AUDIT COMMITTEE PRE-APPROVAL OF AUDIT AND PERMISSIBLE NON-AUDIT SERVICES OF INDEPENDENT AUDITORS

The Company has no audit committee. The Board of Directors' policy is to pre-approve all audit and permissible non-audit services provided by the independent auditors. These services may include audit services, audit-related services, tax services and other services. Pre-approval would generally be

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

provided for up to one year and any pre-approval would be detailed as to the particular service or category of services, and would be subject to a specific budget. The independent auditors and management are required to periodically report to the Board of Directors regarding the extent of services provided by the independent auditors in accordance with this pre-approval, and the fees for the services performed to date. The Board of Directors may also pre-approve particular services on a case-by-case basis.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Eye Dynamics, Inc.

By: /s/ Charles E. Phillips

Charles E. Phillips, President
and Chief Financial Officer

Date: April 6, 2005

In accordance with the Exchange Act, this report has been signed below by the following persons On behalf of the Registrant and in the capacities and on the dates indicated:

Signature -----	Title -----	Date ----
/s/ Charles E. Phillips Charles E. Phillips	President, Chief Financial Officer and a Director	April 6, 2005
/s/ Ronald A. Waldorf Ronald A. Waldorf	Chairman, Chief Executive Officer and a Director	April 6, 2005
/s/ Arnold Kay Arnold Kay	Director	April 6, 2005

HAROLD Y. SPECTOR, CPA
CAROL S. WONG, CPA

SPECTOR & WONG, LLP
Certified Public Accountants
1- (888) 584-5577
FAX (626) 584-6447

80 SOUTH LAKE AVENUE
SUITE 723
PASADENA, CA 91101

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and stockholders of Eye Dynamics, Inc.

We have audited the accompanying balance sheets of Eye Dynamics, Inc. as of December 31, 2004 and 2003, and the related statements of operations, changes in stockholders' deficit, and cash flows for the years ended December 31, 2004 and 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial positions of Eye Dynamics, Inc. as of December 31, 2004 and 2003, and its operations and its cash flows for the years ended December 31, 2004 and 2003, in conformity with accounting principles generally accepted in the United States of America.

Spector & Wong, LLP
Pasadena, California
March 9, 2005
(Except for Note 16, as to which the date is March 28, 2005)

F-1

EYE DYNAMICS, INC.
BALANCE SHEETS

	ASSETS	
Current Assets	2004	2003
	-----	-----
Cash	\$ 847,235	\$ 700,34
Accounts receivable, net of allowance of doubtful accounts of \$899 and \$0, respectively	44,492	131,42
Note receivable, net of allowance of loan loss of \$58,218	19,731	-
Inventory	180,708	319,95
Prepaid expenses	37,641	37,23
	-----	-----
Total Current Assets	1,129,807	1,188,94
Property and equipment, net of accumulated depreciation		

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

of \$13,569 and \$13,341, respectively	875	1,10
Other Assets	229,395	216,99
	-----	-----
TOTAL ASSETS	\$ 1,360,077	\$ 1,407,05
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	\$ 15,622	\$ 12,23
Accrued liabilities	38,073	94,57
Notes payable, current portion	--	95,04
	-----	-----
Total Current Liabilities	53,695	201,84
Long-term debt	40,000	325,13
	-----	-----
Total Liabilities	93,695	526,98
	-----	-----
Stockholders' Equity		
Common Stock, \$0.001 par value; 50,000,000 shares authorized; 17,883,081 shares issued and outstanding	17,883	17,88
Paid-in Capital	3,497,070	3,497,07
Accumulated Deficit	(2,248,571)	(2,634,88)
	-----	-----
Total stockholders' equity	1,266,382	880,06
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 1,360,077	\$ 1,407,05
	=====	=====

See notes to financial statements

F-2

EYE DYNAMICS, INC.
STATEMENTS OF OPERATIONS

FOR YEARS ENDED DECEMBER 31,	2004	2003
	-----	-----
Sales		
Products	\$ 2,084,538	\$ 3,230,284
Services	--	8,000
	-----	-----
Total sales	2,084,538	3,238,284
	-----	-----
Cost of Sales		
Products	1,053,552	1,567,414
Services	--	2,144
	-----	-----
Total cost of sales	1,053,552	1,569,558

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

Gross Profit	1,030,986	1,668,726
Selling, General and Administrative Expenses	691,658	720,248
Operating income	339,328	948,478
Other Income (Expense)		
Interest and Other Income	9,300	819
Gain on early extinguishment of debt	28,621	--
Interest and Other Expense	(3,931)	(17,551)
Total other income (expenses)	33,990	(16,732)
Net income before taxes and extraordinary item	373,318	931,746
Provision for Income Taxes (Benefits)	(12,997)	(111,281)
Net income	\$ 386,315	\$ 1,043,027
Net income per share-Basic	\$ 0.02	\$ 0.06
Net income per share-Diluted:	\$ 0.02	\$ 0.05
Shares used in per share calculation-Basic	17,883,081	17,853,044
Shares used in per share calculation-Diluted	21,765,478	21,797,759

See notes to financial statements

F-3

EYE DYNAMICS, INC.
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR YEARS ENDED DECEMBER 31, 2004 AND 2003

	Common Stock Shares	Amount	Paid-in Capital	Accumulated Deficit	Total
Balance at 12/31/02	17,850,313	\$ 17,850	\$ 3,497,103	\$ (3,677,913)	\$ (16,377,867)
Exercise of warrants under noncash provision	32,768	33	(33)		
Net Income				1,043,027	1,043,027
Balance at 12/31/03	17,883,081	17,883	3,497,070	(2,634,886)	88,525,264

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

Net Income				386,315	38
Balance at 12/31/04	17,883,081	\$ 17,883	\$ 3,497,070	\$ (2,248,571)	\$1,26

See notes to financial statements

F-4

EYE DYNAMICS, INC.
STATEMENTS OF CASH FLOWS

FOR YEARS ENDED DECEMBER 31,	2004	2003
CASH FLOW FROM OPERATING ACTIVITIES:		
Net Income (Loss)	\$ 386,315	\$ 1,000,000
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation	228	(2,000)
Deferred tax benefit	(13,797)	(2,000)
Gain on early extinguishment of debt	(28,621)	(2,000)
(Increase) Decrease in:		
Accounts Receivable	67,197	(1,000)
Inventory	139,245	(1,000)
Prepaid and Others	992	(1,000)
(Decrease) in:		
Accounts Payable and Accrued Expenses	(53,106)	(1,000)
Other Liabilities	--	(1,000)
Net cash provided by operating activities	498,453	600,000
CASH FLOW FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	--	(1,000)
Net cash (used in) investing activities	--	(1,000)
CASH FLOW FROM FINANCING ACTIVITIES:		
Repayments on notes payable	(351,562)	(1,000)
Net cash (used in) financing activities	(351,562)	(1,000)
NET INCREASE IN CASH	146,891	500,000
CASH BALANCE AT BEGINNING OF YEAR	700,344	1,000,000
CASH BALANCE AT END OF YEAR	\$ 847,235	\$ 700,000

Supplemental Disclosures of Cash Flow Information:

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

Interest Paid	\$	--	\$
Taxes Paid	\$	59,355	\$
Taxes (Refund)	\$	(21,118)	\$
Supplemental Schedules of Noncash Investing and Financing Activities			
Conversion of account receivable into note receivable	\$	19,731	\$
Exercise warrant under noncash provision	\$	--	\$

See notes to financial statements

F-5

EYE DYNAMICS, INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 - NATURE OF BUSINESS AND CRITICAL ACCOUNTING POLICIES

NATURE OF BUSINESS: Eye Dynamics, Inc. (the "Company") designs, develops, produces and markets diagnostic equipment that measures, tracks and records human eye movements, utilizing the Company's proprietary technology and computer software. The products perform separate, but related, functions and target two separate markets. First, the Company markets a neurological diagnostic product that tracks and measures eye movements during a series of standardized tests, as an aid in diagnosing problems of the vestibular (balance) system and other balance disorders. Second, the Company's impairment detection devices target the corporate and criminal justice markets and are designed to test individuals for impaired performance resulting from the influences of alcohol, drugs, illness, stress and other factors that affect eye and pupil performance. The Company is a Nevada corporation formed in 1989 and qualified to do business in California in 1992.

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

USE OF ESTIMATES: The preparation of the accompanying financial statements in conformity with accounting principles generally accepted in the United States (U.S. GAAP) requires management to make certain estimates and assumptions that directly affect the results of reported assets, liabilities, revenue, and expenses. Actual results may differ from these estimates.

REVENUE RECOGNITION: The Company is subcontracting the manufacturing of the medical diagnostic equipments and products. Manufacturing operations consist of assembly, test, and packaging functions. Sales of product and equipment are recognized when both title and risk of loss transfers to the customer (usually it is the date of shipment), provided that no significant obligations remain and collectibility is reasonably assured. No provisions were established for estimated product returns and allowances based on the Company's historical experience.

The Company provides repair and maintenance, consulting and education services to its customers. Revenue from such services is generally recognized over the period during which the applicable service is to be performed or on a

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

service-performed basis.

The Company evaluated Statement of Position No. 97-2, "Software Revenue Recognition" ("SOP 97-2"), but does not expect that SOP 97-2 will have a material impact on the Company's financial position, results of operations, or cash flows since the Company did not sell, license, lease or market any individual computer software. The Company's computer software is included with the equipment and is not sold separately.

ACCOUNTS RECEIVABLE: The Company carries its accounts receivable at cost less an allowance for doubtful accounts. On a periodic basis, the Company evaluates its accounts receivable and establishes an allowance for doubtful accounts, based on a history of past write-offs and collections and current credit conditions.

STOCK-BASED COMPENSATION: SFAS No. 148. "Accounting for Stock-Based Compensation - Transition and Disclosure, an Amendment of FASB Statement No. 123," amends the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," to require more prominent disclosures in both annual and interim financial statements regarding the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

F-6

EYE DYNAMICS, INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 - NATURE OF BUSINESS AND CRITICAL ACCOUNTING POLICIES (CONTINUED)

The Company accounts for equity-based instruments issued or granted to employees using the intrinsic method of accounting in accordance with Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Under the intrinsic value method, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized in the Company's Consolidated Statements of Operations.

The Company is required under SFAS 123 to disclose pro forma information regarding option grants to its employees based on specified valuation techniques that produce estimated compensation charges. The pro forma information is as follows:

	2004	2003
	-----	-----
Net income-as reported	\$ 386,315	\$ 1,043,027
Pro forma compensation expense	-	-
	-----	-----
Pro forma net income	\$ 386,315	\$ 1,043,027
	=====	=====
Basic earnings per share:		
As reported	\$0.02	\$0.06
Pro forma	\$0.02	\$0.06
Diluted earnings per share:		
As reported	\$0.02	\$0.05
Pro forma	\$0.02	\$0.05

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

The value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model, which was developed for use in estimating the value of traded options that have no vesting restrictions and are fully transferable. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the estimate, in management's opinion, the existing valuation models do not provide a reliable measure of the fair value of the Company's employee stock options. (For additional information regarding this pro forma information, see Note to the Consolidated Financial Statements.)

The Company accounts for stock issued to non-employees in accordance with the provisions of SFAS No. 123 and the EITF Issue No. 00-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services." SFAS No. 123 states that equity instruments that are issued in exchange for the receipt of goods or services should be measured at the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. Under the guidance in Issue 00-18, the measurement date occurs as of the earlier of (a) the date at which a performance commitment is reached or (b) absent a performance commitment, the date at which the performance necessary to earn the equity instruments is complete (that is, the vesting date).

EARNINGS PER SHARE: Basic earnings per share includes no dilution and is computed by dividing net income available to common stockholders by the weighted average number of common stock outstanding for the period. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the period, plus the dilutive effect of outstanding stock warrants and shares issuable under convertible debt, using the treasury stock method.

F-7

EYE DYNAMICS, INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 - NATURE OF BUSINESS AND CRITICAL ACCOUNTING POLICIES (CONTINUED)

Other Significant Accounting Policies:

CASH EQUIVALENTS: For purposes of the statements of cash flows, the Company considers all highly liquid debt instruments with an original maturity of three months or less to be cash equivalents.

The Company maintains its cash in one financial institution. The bank account, at times, exceeded federally insured limits of \$100,000. The Company has not experienced any losses on such account.

FAIR VALUE OF FINANCIAL INSTRUMENTS: The carrying amounts of the financial instruments have been estimated by management to approximate fair value.

INVENTORIES: Costs incurred for materials, technology and shipping are capitalized as inventories and charged to cost of sales when revenue is recognized. Inventories consist of finished goods and are stated at the lower of cost or market, using the first-in, first-out method.

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

PROPERTY AND EQUIPMENT: Property and Equipment are valued at cost. Maintenance and repair costs are charged to expenses as incurred. Depreciation is computed on the straight-line method based on the following estimated useful lives of the assets: 5 to 7 years for computer and office equipment, and 7 years for furniture and fixtures. Depreciation expense was \$228 and \$408 for 2004 and 2003, respectively.

INCOME TAXES: Income tax expense is based on pretax financial accounting income. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts.

ADVERTISING COSTS: All advertising costs are expensed as incurred. Advertising expenses were \$0 and \$40 for 2004 and 2003, respectively.

SHIPPING AND HANDLING COSTS: The Company historically has included inbound shipping charges in cost of sales and classified outbound shipping charges as operating expenses. For the years ended December 31, 2004 and 2003, the outbound shipping charges included in operating expenses were \$62,548 and \$75,203, respectively.

RECLASSIFICATION: Certain reclassifications have been made to the 2003 financial statements to conform with the 2004 consolidated financial statement presentation. Such reclassification had no effect on net loss as previously reported.

NEW ACCOUNTING PRONOUNCEMENTS: In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 153. This statement addresses the measurement of exchanges of nonmonetary assets. The guidance in APB Opinion No. 29, "Accounting for Nonmonetary Transactions," is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in that opinion; however, included certain exceptions to that principle. This statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This statement is effective for financial statements for fiscal years beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges incurred during fiscal years beginning after the date of this statement is issued. Management believes the adoption of this statement will have no impact on the financial statements of the Company.

F-8

EYE DYNAMICS, INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 - NATURE OF BUSINESS AND CRITICAL ACCOUNTING POLICIES (CONTINUED)

In December 2004, the FASB issued SFAS No. 152, which amends FASB statement No. 66, "Accounting for Sales of Real Estate," to reference the financial accounting and reporting guidance for real estate time-sharing transactions that is provided in AICPA Statement of Position (SOP) 04-2, "Accounting for Real Estate Time-Sharing Transactions." This statement also

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

amends FASB Statement No. 67, "Accounting for Costs and Initial Rental Operations of Real Estate Projects," to state that the guidance for (a) incidental operations and (b) costs incurred to sell real estate projects does not apply to real estate time-sharing transactions. The accounting for those operations and costs is subject to the guidance in SOP 04-2. This statement is effective for financial statements for fiscal years beginning after June 15, 2005. Management believes the adoption of this statement will have no impact on the financial statements of the Company.

In December 2004, the FASB issued a revision to SFAS No. 123R, "Accounting for Stock Based Compensations." This statement supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. This statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. This statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. This statement does not change the accounting guidance for share based payment transactions with parties other than employees provided in SFAS No. 123. This statement does not address the accounting for employee share ownership plans, which are subject to AICPA Statement of Position 93-6, "Employers' Accounting for Employee Stock Ownership Plans." The Company has not yet determined the impact to its financial statements from the adoption of this statement.

In November 2004, the FASB issued SFAS No. 151, "INVENTORY COSTS -- AN AMENDMENT OF ARB NO. 43, CHAPTER 4." This statement amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB 43, Chapter 4, previously stated that ". . . under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges. . . ." This statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, this statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Management does not believe the adoption of this statement will have any immediate material impact on the Company.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" (hereinafter "SFAS No. 150"). SFAS No. 150 establishes standards for classifying and measuring certain financial instruments with characteristics of both liabilities and equity and requires that those instruments be classified as liabilities in statements of financial position. Previously, many of those instruments were classified as equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company's adoption of this statement did not have an impact on the financial statements of the Company.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" (hereinafter "SFAS No. 149"). SFAS No. 149 amends and clarifies the accounting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". This statement is effective for contracts entered into or modified after June 30, 2003 and for hedging

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have an impact on the financial statements of the Company.

F-9

EYE DYNAMICS, INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 - NATURE OF BUSINESS AND CRITICAL ACCOUNTING POLICIES (CONTINUED)

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51. Interpretation 46 establishes accounting guidance for consolidation of variable interest entities that function to support the activities of the primary beneficiary. Interpretation 46 applies to any business enterprise, both public and private, that has a controlling interest, contractual relationship or other business relationship with a variable interest entity. The Company currently has no contractual relationship or other business relationship with a variable interest entity and therefore the adoption did not have an effect on its consolidated financial position or results of operations. However, if the Company enters into any such arrangement with a variable interest entity in the future, its financial position or results of operations may be adversely impacted.

NOTE 2 - BALANCE SHEET DETAILS

The following tables provide details of selected balance sheet items:

At December 31,	2004	2003

Prepaid Expenses:		
Prepaid Insurance	\$ 27,341	\$ 34,704
Prepaid Taxes	4,560	--
Other Prepaid Expenses	5,740	2,528

Total	\$ 37,641	\$ 37,232
=====		
Property and equipment, net		
Furniture and Fixtures	\$ 1,113	\$ 1,113
Equipment	13,331	13,331

	14,444	14,444
Less: accumulated depreciation	(13,569)	(13,341)

Total	\$ 875	\$ 1,103
=====		
Other Assets		
Deferred tax assets	\$ 219,233	\$ 205,436
Deposits	10,162	11,563

Total	\$ 229,395	\$ 216,999
=====		
Accrued liabilities		
Accrued Insurance	\$ 17,079	\$ 23,104
Warranty reserve	8,884	8,044

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

Sales tax payable	2,171	20,065
Income tax payable	--	40,251
Other	9,939	3,106

Total	\$ 38,073	\$ 94,570
=====		

F-10

EYE DYNAMICS, INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 3 - LINE OF CREDIT

The Company has an operating line of credit with Wells Fargo Bank of \$75,000, with interest payable at the bank's prime rate plus 2.75% (6.25% at December 31, 2004). This line of credit is payable on demand and is personally guaranteed by the Company's President. The Company did not borrow against this line of credit during 2004 and 2003.

NOTE 4 - LONG-TERM DEBT

Long-term debt consists of the following:

At December 31,	2004	2003

a.) Restructured note payable to TESA Corp., interest at 7% commencing January 1, 2003, due on December 31, 2007. Collateralized by accounts receivable, inventory, patents and a licensing agreement for impairment testing products	\$ --	\$ 380,183
b.) Note Payable to Others, interest at 7% due and payable on December 31, 2007. Convertible into 2,394,533 shares of common stock	26,666	26,666
c.) Note Payable to Others, interest at 7% due and payable on December 31, 2007. Convertible into 1,197,267 shares of common stock	13,334	13,334

	40,000	420,183
Less: Current Maturities	--	(95,046)

Long-term debt	\$ 40,000	\$ 325,137
=====		

NOTE 5 - EXTINGUISHMENT OF DEBT

In December 2004, the Company paid off a promissory note of \$400,000 that was restructured in 2003 (see Note 4a); as a result, the Company recognized a gain of \$28,621 which was classified as a nonoperating income in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125."

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

NOTE 6 - PRIOR PERIOD ADJUSTMENT

An understatement of 2002 reported income tax payable of \$12,699 was discovered during the second quarter of 2003. The Company charged this error to the 2003 operations and did not restate the 2002 financial statements. Management believes that the restatement did not have material effect on the Company's financial position, results of operations and cash flows.

NOTE 7 - NONCASH FINANCING ACTIVITIES

In 2003, a warrant holder exercised 66,666 of its stock warrants in the Company at the price of \$0.32 per share. The warrant holder elected the Net Issue Exercise (noncash) provision of the warrant agreement. As a result, the Company issued 32,768 shares of common stock to the warrant holder without any cash proceeds.

F-11

EYE DYNAMICS, INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 8 - INCOME TAXES

The provision for income taxes (benefits) consisted of the following:

FOR YEAR ENDED DECEMBER 31,	2004	2003
Federal:		
Current	\$ --	\$ 9,118
Deferred	(46,828)	(125,678)
	(46,828)	(116,560)
State:		
Current	800	85,037
Deferred	33,031	(79,758)
	33,831	5,279
Total	\$ (12,997)	\$ (111,281)

The components of the deferred net tax assets are as follows:

At December 31,	2004	2003
Net Operating Loss Carryforwards	\$229,186	\$204,963
Property and equipment	209	473
Valuation Allowance	--	--
Net deferred tax assets	\$229,395	\$205,436

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

At December 31, 2002, the Company provided a valuation allowance on the deferred tax assets because of uncertainty regarding its ability to utilize its net operating loss carryforwards. As of December 31, 2003, the Company had removed the valuation allowance because it believed it was more likely than not that all deferred tax assets would be realized in the foreseeable future and was reflected as a credit to operations.

As of December 31, 2004, the Company has net operating loss carryforwards, approximately, of \$1,149,163 and \$527,713 to reduce future federal and state taxable income. To the extent not utilized, the federal net operating loss carryforwards will begin to expire in fiscal 2021 and the state net operating loss carryforwards will begin to expire in fiscal 2005.

NOTE 9 - STOCKS OPTIONS AND WARRANTS

Stock Options

All stock options expired in 2003. No new issued in 2004. The Company had no stock options outstanding as of December 31, 2004 and December 31, 2003.

Stock Warrants

The Company had 333,333 warrants outstanding as of December 31, 2004 and 2003. The warrants are exercisable at \$0.05 per share and expire on December 31, 2007.

F-12

EYE DYNAMICS, INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 10 - NET INCOME PER SHARE

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

YEARS ENDED DECEMBER 31,	2004	2003

Numerator:		
Net income	\$ 386,315	\$ 1,043,027

Denominator:		
Weighted average of common shares-basic	17,883,081	17,853,044
Diluted effect of stock warrants	290,598	303,030
Diluted effect of convertible debt	3,591,799	3,641,685

Weighted average common shares-diluted	21,765,478	21,797,759
=====		
Basic net income per share	\$ 0.02	\$ 0.06
=====		
Diluted net income per share	\$ 0.02	\$ 0.05
=====		

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

NOTE 11 - SEGMENT INFORMATION

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

NOTE 12 - MAJOR CUSTOMERS

During year ended December 31, 2004, two major customers accounted for \$1,541,423 or 73.8% of total revenues.

Special Instrument Dealer 11.4%
Private label distributor 62.4%

During year ended December 31, 2003, two major customers accounted for \$2,335,240 or 72.1% of total revenues.

Special Instrument Dealer 18.9%
Private label distributor 53.2%

NOTE 13 - MANUFACTURING, SALES, LICENSING, AND SOFTWARE AGREEMENT

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

F-13

EYE DYNAMICS, INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 14 - LEASE COMMITMENTS

In February 2003, the Company relocated to a larger office facility for \$1,571 per month. The new lease commences on February 1, 2003 and expires through January 31, 2006. Rent expense totaled \$21,186 and \$21,740 for 2004 and 2003, respectively.

The Company also leases a copier for \$205 per month expiring in October 2008. The monthly lease payment does not include additional maintenance, insurance and per copy charges.

As of December 31, 2004, the minimum lease payments under these leases are:

Year ended	Amount
December 31,	
-----	-----

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

2005	\$22,436
2006	4,123
2007	2,455
2008	2,046

	\$31,060
	=====

NOTE 15 - GUARANTEES AND PRODUCT WARRANTIES

The Company from time to time enters into certain types of contracts that contingently require the Company to indemnify parties against third party claims. These contracts primarily relate to: (i) divestiture agreements, under which the Company may provide customary indemnifications to purchasers of the Company's businesses or assets; (ii) certain real estate leases, under which the Company may be required to indemnify property owners for environmental and other liabilities, and other claims arising from the Company's use of the applicable premises; and (iii) certain agreements with the Company's officers, directors and employees, under which the Company may be required to indemnify such persons for liabilities arising out of their employment relationship.

The terms of such obligations vary. Generally, a maximum obligation is not explicitly stated. Because the obligated amounts of these types of agreements often are not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, the Company has not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations on its balance sheet as of December 31, 2004.

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

F-14

EYE DYNAMICS, INC.

NOTES TO FINANCIAL STATEMENTS

The following table presents the changes in the Company's warranty reserve in the fiscal years December 31, 2004 and 2003 are as follows:

Years ended December 31,	2004	2003
	-----	-----
Beginning balance	\$ 8,044	\$ 0
Provision for warranty	5,154	8,044
Utilization of reserve	(4,314)	0
	-----	-----
Ending balance	\$ 8,884	\$ 8,044
	=====	=====

Edgar Filing: EYE DYNAMICS INC - Form 10KSB

NOTE 16 -SUBSEQUENT EVENTS

On January 3, 2005, the Board of Directors approved to issue stock options to current directors in the amount of 20,000 shares for each of the years from 1999 through 2004. The total options for each of directors shall be 120,000 shares. The options are vesting immediately and exercisable at \$0.15 per share through January 3, 2007.

On January 11, 2005, the Board of Directors elected the Chairman of the Board to be the Company's new Chief Executive Officer (CEO). The former CEO remains as the Company's chief financial officer and president.

On March 24, 2005, the Company announced intent to acquire 100% issued and outstanding shares of OrthoNetx, Inc., a Colorado-based provider of medical devices for osteoplastic surgery. The acquisition will be completed as a stock transaction in which OrthoNetx shareholders will receive one share of the Company's stock in exchange for each share of OrthoNetx stock. The acquisition is subject to certain customary conditions including certain regulatory approvals. As part of the transaction, the President and CEO of OrthoNetx will assume the position of CEO of the merged company.

F-15