

ALLIED HEALTHCARE PRODUCTS INC

Form 10-K

September 25, 2009

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549**

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year June 30, 2009**

**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 0-19266**

**ALLIED HEALTHCARE PRODUCTS, INC.**

[Exact Name of Registrant As Specified in Its Charter]

DELAWARE

25-1370721

(State or Other Jurisdiction of  
Incorporation or Organization)

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

1720 Sublette Avenue  
St. Louis, Missouri  
(Address of Principal Executive Offices)

63110  
(Zip Code)

Registrant's Telephone Number, Including Area Code (314) 771-2400

**SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:**

| Title of Each Class | Name of Each Exchange<br>on Which Registered |
|---------------------|--|
| Common Stock, \$.01 | The NASDAQ Stock Market LLC                  |

**SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.  
Yes  No

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not 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-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12 b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12 b-2). Yes  No

As of December 31, 2008, the last business day of the registrant's most recently completed second fiscal quarter; the aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$14,298,175.

As of September 19, 2009, there were 8,091,886 shares of common stock, \$0.01 par value (the Common Stock), outstanding.

## **DOCUMENTS INCORPORATED BY REFERENCE**

Proxy Statement to be dated October 9, 2009 (portion) (Part III)

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SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION  
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*Statements contained in this Report, which are not historical facts or information, are forward-looking statements. Words such as believe, expect, intend, will, should, and other expressions that indicate future events and trends identify such forward-looking statements. These forward-looking statements involve risks and uncertainties, which could cause the outcome and future results of operations and financial condition to be materially different than stated or anticipated based on the forward-looking statements. Such risks and uncertainties include both general economic risks and uncertainties, risks and uncertainties affecting the demand for and economic factors affecting the delivery of health care services, and specific matters which relate directly to the Company's operations and properties as discussed in Items 1, 1A, 3 and 7 in this Report. The Company cautions that any forward-looking statements contained in this report reflect only the belief of the Company or its management at the time the statement was made. Although the Company believes such forward-looking statements are based upon reasonable assumptions, such assumptions may ultimately prove inaccurate or incomplete. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement was made.*

## **PART I**

### **Item 1. Business**

#### **General**

Allied Healthcare Products, Inc. (Allied or the Company) manufactures a variety of respiratory products used in the health care industry in a wide range of hospital and alternate site settings, including sub-acute care facilities, home health care and emergency medical care. The Company's product lines include respiratory care products, medical gas equipment and emergency medical products. The Company believes that it maintains significant market shares in selected product lines.

The Company's products are marketed under well-recognized and respected brand names to hospitals, hospital equipment dealers, hospital construction contractors, home health care dealers, emergency medical products dealers and others. Allied's product lines include:

#### **Respiratory Care Products**

respiratory care/anesthesia products  
home respiratory care products

#### **Medical Gas Equipment**

medical gas system construction products  
medical gas system regulation devices  
disposable oxygen and specialty gas cylinders  
portable suction equipment

#### **Emergency Medical Products**

respiratory/resuscitation products  
trauma and patient handling products

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The Company's principal executive offices are located at 1720 Sublette Avenue, St. Louis, Missouri 63110, and its telephone number is (314) 771-2400.

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In fiscal 2009, respiratory care products, medical gas equipment and emergency medical products represented approximately 24%, 57% and 19%, respectively, of the Company's net sales. In comparison, in fiscal 2008, respiratory care products, medical gas equipment and emergency medical products represented approximately 25%, 55%, and 20%, respectively, of the Company's net sales. The Company operates in a single industry segment and its principal products are described in the following table:

| Product                                  | Description  | Principal Brand Names       | Primary Users   |
|--|--|-----------------------------|---|
| Respiratory Care Products                |  |                             |   |
| Respiratory Care/<br>Anesthesia Products | Large volume compressors; ventilator calibrators; humidifiers and mist tents; and CO2 absorbent  | Timeter                     | Hospitals and sub-acute facilities                    |
| Home Respiratory Care Products           | O2 cylinders; pressure regulators; nebulizers; portable large volume compressors; portable suction equipment and disposable respiratory products                                 | Timeter; B&F; Schuco        | Patients at home                                      |
| Medical Gas Equipment                    |  |                             |   |
| Construction Products                    | In-wall medical gas system components; central station pumps and compressors and headwalls   | Chemetron; Oxequip          | Hospitals and sub-acute facilities                    |
| Regulation Devices                       | Flowmeters; vacuum regulators; pressure regulators and related products  | Chemetron; Oxequip; Timeter | Hospitals and sub-acute facilities                    |
| Disposable Cylinders                     | Disposable oxygen and gas cylinders  | Lif-O-Gen                   | First aid providers and specialty gas distributors    |
| Suction Equipment                        | Portable suction equipment and disposable suction canisters  | Gomco; Allied; Schuco       | Hospitals, sub-acute facilities and homecare products |
| Emergency Medical Products               |  |                             |   |
| Respiratory/Resuscitation                | Demand resuscitation valves; bag mask resuscitators; emergency transport ventilators, oxygen regulators, SurgeX surge suppressing post valve, and mass casualty ventilation line | LSP; Omni-Tech              | Emergency service providers                           |
| Trauma and Patient Handling Products     | Spine immobilization products; pneumatic anti-shock garments, trauma burn kits and Xtra backboards   | LSP                         | Emergency service providers                           |



## Respiratory Care Products

**Market.** Respiratory care products are used in the treatment of acute and chronic respiratory disorders such as asthma, emphysema, bronchitis and pneumonia. Respiratory care products are used in both hospitals and alternate care settings. Sales of respiratory care products are made through distribution channels focusing on hospitals and other sub-acute facilities. Sales of home respiratory care products are made through durable medical equipment dealers through telemarketing, and by contract sales with national chains.

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**Respiratory Care/Anesthesia Products.** The Company manufactures and sells a broad range of products for use in respiratory care and anesthesia delivery. These products include large volume air compressors, calibration equipment, humidifiers, croup tents, equipment dryers and a complete line of respiratory disposable products such as oxygen tubing, facemasks, cannulas and ventilator circuits.

**Home Respiratory Care Products.** Home respiratory care products represent one of Allied's potential growth areas. Allied's broad line of home respiratory care products include aluminum oxygen cylinders, oxygen regulators, pneumatic nebulizers, portable suction equipment and the full line of respiratory disposable products.

## **Medical Gas Equipment**

**Market.** The market for medical gas equipment consists of hospitals, alternate care settings and surgery centers. The medical gas equipment group is broken down into three separate categories: construction products, regulation devices and suction equipment, and disposable cylinders.

**Construction Products.** Allied's medical gas system construction products consist of in-wall medical system components, central station pumps and compressors, and headwalls. These products are typically installed during construction or renovation of a health care facility and are built in as an integral part of the facility's physical plant. Typically, the contractor for the facility's construction or renovation purchases medical gas system components from manufacturers and ensures that the design specifications of the health care facility are met.

Allied's in-wall components, including outlets, manifolds, alarms, ceiling columns and zone valves, serve a fundamental role in medical gas delivery systems.

Central station pumps and compressors are individually engineered systems consisting of compressors, reservoirs, valves and controls designed to drive a hospital's medical gas and suction systems. Each system is designed specifically for a given hospital or facility, which purchases pumps and compressors from suppliers. The Company's sales of pumps and compressors are driven, in large part, by its share of the in-wall components market.

The Company's construction products are sold primarily to hospitals, alternate care settings and hospital construction contractors. The Company believes that it holds a major share of the U.S. market for its construction products, that these products are installed in more than three thousand hospitals in the United States and that its installed base of equipment in this market will continue to generate follow-on sales. The Company believes that most hospitals and sub-acute care facility construction spending is for expansion or renovation of existing facilities. Many hospital systems and individual hospitals undertake major renovations to upgrade their operations to improve the quality of care they provide, reduce costs and attract patients and personnel.

**Regulation Devices and Suction Equipment.** The Company's medical gas system regulation products include flowmeters, vacuum regulators and pressure regulators, as well as related adapters, fittings and hoses which measure, regulate, monitor and help transfer medical gases from walled piping or equipment to patients in hospital rooms, operating theaters or intensive care areas. The Company's leadership position in the in-wall components market provides a competitive advantage in marketing medical gas system regulation devices that are compatible with those components.

Portable suction equipment is typically used when in-wall suction is not available or when medical protocol specifically requires portable suction. The Company also manufactures disposable suction canisters, which are clear containers used to collect the fluids suctioned by in-wall or portable suction systems. The containers have volume

calibrations, which allow the medical practitioner to measure the volume of fluids suctioned.

The market for regulation devices and suction equipment includes hospital and sub-acute care facilities. Sales of these products are made through the same distribution channel as our respiratory care products. The Company believes that it holds a significant share of the U.S. market in both regulation devices and suction equipment.

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**Disposable Cylinders.** Disposable oxygen cylinders are designed to provide oxygen for short periods of time in emergency situations. Since they are not subjected to the same pressurization as standard containers, they are much lighter and less expensive than standard gas cylinders. The Company markets filled disposable oxygen cylinders through industrial safety distributors and similar customers, principally to first aid providers, restaurants, industrial plants and other customers that require oxygen for infrequent emergencies.

## **Emergency Medical Products**

**Market.** Emergency medical products are used in the treatment of trauma-induced injuries. The Company's emergency medical products provide patient resuscitation or ventilation during cardiopulmonary resuscitation or respiratory distress as well as immobilization and treatment for burns. The Company has seen growth in the trauma care venue for health care services, as the trend continues toward providing health care outside the traditional hospital setting. The Company also expects that other countries will develop trauma care systems in the future, although no assurance can be given that such systems will develop or that they will have a favorable impact on the Company.

Sales of emergency medical products are made through specialized emergency medical products distributors to ambulance companies, fire departments and emergency medical systems volunteer organizations.

The emergency medical products are broken down into two categories: respiratory/resuscitator products and trauma patient handling products.

**Respiratory/Resuscitation Products.** The Company's respiratory/resuscitation products include demand resuscitation valves, portable resuscitation systems, bag masks and related products, emergency transport ventilators, precision oxygen regulators, minilators, multilators and humidifiers.

Demand resuscitation valves are designed to provide 100% oxygen to breathing or non-breathing patients. In an emergency situation, they can be used with a mask or tracheotomy tubes and operate from a standard regulated oxygen system. The Company's portable resuscitation systems provide fast, simple and effective means of ventilating a non-breathing patient during cardiopulmonary resuscitation and 100% oxygen to breathing patients on demand with minimal inspiratory effort. The Company also markets a full line of disposable and reusable bag mask resuscitators, which are available in a variety of adult and child-size configurations. Disposable mouth-to-mask resuscitation systems have the added advantage of reducing the risk of transmission of communicable diseases.

The Company's autovent transport ventilator can meet a variety of needs in different applications ranging from typical emergency medical situations to more sophisticated air and ground transport. Each autovent is accompanied by a patient valve, which provides effective ventilation during cardiopulmonary resuscitation or respiratory distress. When administration of oxygen is required at the scene of a disaster, in military field hospitals or in a multiple-victim incident, Allied's minilators and multilators are capable of providing oxygen to one or a large number of patients.

The Company's mass casualty ventilation line has been designed to meet the unique ventilation demands that can occur during a mass casualty event or pandemic. The mass casualty products are lightweight, robust, and easy to operate.

Designed for surge capacity, these products are capable of providing reliable ventilation even in unpredictable environments and conditions, and require minimal periodic maintenance.

To complement the family of respiratory/resuscitation products, the Company offers a full line of oxygen product accessories. This line of accessory products includes reusable aspirators, tru-fit masks, disposable cuffed masks and related accessories.

***Trauma and Patient Handling Products.*** The Company's trauma and patient handling products include spine immobilization products, pneumatic anti-shock garments and trauma burn kits. Spine immobilization products include a backboard that is designed for safe immobilization of injury victims and provides a durable and cost effective means of emergency patient transportation and extrication. The infant/pediatric immobilization board is durable and scaled for children. The half back extractor/rescue vest is useful for both suspected cervical/spinal injuries and for mountain and air rescues. The Company's pneumatic anti-shock garments are used to treat victims experiencing hypovolemic shock. Allied's trauma burn kits contain a comprehensive line of products for the treatment of trauma and burns.

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## **Sales and Marketing**

Allied sells its products primarily to respiratory care/anesthesia product distributors, hospital construction contractors, emergency medical equipment dealers and directly to hospitals. The Company maintains a sales force of 34 sales professionals, all of whom are full-time employees of the Company.

The sales force includes 10 domestic hospital specialists, 10 domestic construction specialists, 4 emergency specialists and 6 international sales representatives. A total of four sales managers lead each of the sales groups. Two product managers are responsible for the marketing activities of our product lines.

The domestic hospital specialists are responsible for sales of all Allied products with the exception of construction products within their territory. The domestic construction specialists are responsible for sales of all Allied construction products within their territory. Sales of products are accomplished through respiratory care/anesthesia distributors for the regulation devices, suction equipment, respiratory care/anesthesia products and disposable cylinders. The homecare products are sold primarily through our own in house telemarketing. Construction products are sold direct to hospital construction contractors and through distributors.

Emergency medical specialists are responsible for sales of respiratory/resuscitation products, trauma and patient handling products. These products are principally sold to ambulance companies, fire departments and emergency medical systems volunteer organizations through specialized emergency medical products distributors.

The international specialists sell all Allied products within their territory. Allied's net sales to foreign markets totaled 19% of the Company's net sales in fiscal 2009, compared to 19% in fiscal 2008, and 18% in fiscal 2007. International sales are made through a network of dealers, agents and U.S. exporters who distribute the Company's products throughout the world. Allied has market presence in Canada, Mexico, Central and South America, Europe, the Middle East and the Far East.

## **Manufacturing**

Allied's manufacturing processes include fabrication, electro-mechanical assembly operations and plastics manufacturing. A significant part of Allied's manufacturing operations involves electro-mechanical assembly of proprietary products and the Company is vertically integrated in most elements of metal machining and fabrication. Most of Allied's hourly employees are involved in machining, metal fabrication, plastics manufacturing and product assembly.

Allied manufactures small metal components from bar stock in a machine shop, which includes automatic screw machines, horizontal lathes and drill presses and computer controlled machining centers. The Company makes larger metal components from sheet metal using computerized punch presses, brake presses and shears. In its plastics manufacturing processes, the Company utilizes both extrusion and injection molding. The Company believes that its production facilities and equipment are in good condition and sufficient to meet planned increases in volume over the next few years and that the conditions in local labor markets should permit the implementation of additional shifts and days operated.

## **Research and Development**

Allied's research and development department group is responsible for the development of new products. This group is staffed with mechanical and electrical engineers.

During fiscal year 2008 the Autovent 4000 family of ventilators were released for production. These ventilators add models with new features to the existing Autovent line.

During fiscal year 2009 the research and development group has completed the design and released to production the EPV100 ventilator, MCV100 Mass Casualty Ventilator, MCV200 Mass Casualty Ventilator, and EPV200 ventilator.

This line of ventilators has been designed to meet the needs of the mass casualty and pandemic markets.

As part of the agreement relating to the withdrawal of the Baralyme® product in August 2004, Abbott Laboratories agreed to pay to Allied up to \$2,150,000 in product development costs to pursue development of a new carbon dioxide absorption product for use in connection with inhalation anesthetics that does not contain potassium hydroxide and does not produce a significant exothermic reaction with currently available

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inhalation agents. Allied has pursued development of a new carbon dioxide absorption product. As of June 30, 2009 the Company had been reimbursed \$2,150,000 by Abbott. More detailed information concerning this agreement is included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

## **Government Regulation**

The Company's products and its manufacturing activities are subject to extensive and rigorous government regulation by federal and state authorities in the United States and other countries. In the United States, medical devices for human use are subject to comprehensive review by the United States Food and Drug Administration (the FDA). The Federal Food, Drug, and Cosmetic Act (FDC Act), and other federal statutes and regulations, govern or influence the research, testing, manufacture, safety, labeling, storage, record keeping, approval, advertising and promotion of such products. Noncompliance with applicable requirements can result in warning letters, fines, recall or seizure of products, injunction, refusal to permit products to be imported into or exported out of the United States, refusal of the government to clear or approve marketing applications or to allow the Company to enter into government supply contracts, or withdrawal of previously approved marketing applications and criminal prosecution.

The Company is required to file a premarket notification in the form of a premarket approval (PMA) with the FDA before it begins marketing a new medical device that offers new technology that is currently not on the market. The Company also must file a premarket notification in the form of a 510(k) with the FDA before it begins marketing a new medical device that utilizes existing technology for devices that are currently on the market. The 510(k) submission process is also required when the Company makes a change or modifies an existing device in a manner that could significantly affect the device's safety or effectiveness.

Compliance with the regulatory approval process in order to market a new or modified medical device can be uncertain, lengthy and, in some cases, expensive. There can be no assurance that necessary regulatory approvals will be obtained on a timely basis, or at all. Delays in receipt or failure to receive such approvals, the loss of previously received approvals, or failure to comply with existing or future regulatory requirements could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company manufactures and distributes a broad spectrum of respiratory therapy equipment, emergency medical equipment and medical gas equipment. To date, all of the Company's FDA clearances have been obtained through the 510(k) clearance process. These determinations are very fact specific and the FDA has stated that, initially, the manufacturer is best qualified to make these determinations, which should be based on adequate supporting data and documentation. The FDA however, may disagree with a manufacturer's determination not to file a 510(k) and require the submission of a new 510(k) notification for the changed or modified device. Where the FDA believes that the change or modification raises significant new questions of safety or effectiveness, the agency may require a manufacturer to cease distribution of the device pending clearance of a new 510(k) notification. Certain of the Company's medical devices have been changed or modified subsequent to 510(k) marketing clearance of the original device by the FDA. Certain of the Company's medical devices, which were first marketed prior to May 28, 1976, and therefore, grandfathered and exempt from the 510(k) notification process, also have been subsequently changed or modified. The Company believes that these changes or modifications do not significantly affect the devices' safety or effectiveness, or make a major change or modification in the devices' intended uses and, accordingly, submission of new 510(k) notification to the FDA is not required. There can be no assurance, however, that the FDA would agree with the Company's determinations.

In addition, commercial distribution in certain foreign countries is subject to additional regulatory requirements and receipt of approvals that vary widely from country to country. The Company believes it is in compliance with



regulatory requirements of the countries in which it sells its products.

The Medical Device Reporting regulation requires that the Company provide information to the FDA on deaths or serious injuries alleged to have been associated with the use of its devices, as well as product malfunctions that would likely cause or contribute to death or serious injury if the malfunction were to recur. The Medical Device Tracking regulation requires the Company to adopt a method of device tracking of certain devices, such as ventilators, which are life-supporting or life-sustaining devices used outside of a device user facility, some of which are permanently implantable devices. The regulation requires that the method adopted

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by the Company will ensure that the tracked device can be traced from the device manufacturer to the person for whom the device is indicated (i.e., the patient). In addition, the FDA prohibits a company from promoting an approved device for unapproved applications and reviews a company's labeling for accuracy. Labeling and promotional activities also are in certain instances, subject to scrutiny by the Federal Trade Commission.

The Company's medical device manufacturing facilities are registered with the FDA, and have received ISO 9001 certification under the Medical Device Directive (MDD - European) for certain products in 1998. The Company's St. Louis facility is ISO 9000 certified. The Company is subject to audit by the FDA, ISO, and European auditors for compliance with the Good Manufacturing Practices (GMP), the ISO and MDD regulations for medical devices. These regulations require the Company to manufacture its products and maintain its products and documentation in a prescribed manner with respect to design, manufacturing, testing and control activities. The Company also is subject to the registration and inspection requirements of state regulatory agencies.

There can be no assurance that any required FDA or other governmental approval will be granted, or, if granted, will not be withdrawn. Governmental regulation may prevent or substantially delay the marketing of the Company's proposed products and cause the Company to undertake costly procedures. In addition, the extent of potentially adverse government regulation that might arise from future administrative action or legislation cannot be predicted. Any failure to obtain, and maintain, such approvals could adversely affect the Company's ability to market its products or proposed products.

Sales of medical devices outside the United States are subject to foreign regulatory requirements that vary widely from country to country. Medical products shipped to the European Community generally require CE certification. The letters "CE" are an abbreviation of Conformité Européenne, French for European conformity. Whether or not FDA approval has been obtained, approval of a device by a comparable regulatory authority of a foreign country generally must be obtained prior to the commencement of marketing in those countries. The time required to obtain such approvals may be longer or shorter than that required for FDA approval. In addition, FDA approval may be required under certain circumstances to export certain medical devices.

The Company is also subject to numerous federal, state and local laws relating to such matters as safe working conditions, manufacturing practices, environmental protections, fire hazard control and disposal of hazardous or potentially hazardous substances.

## **Patents, Trademarks and Proprietary Technology**

The company owns and maintains patents on several products it believes is useful to the business and provides the company with an advantage over its competitors. During fiscal 2009 the company continued to pursue patents on the construction alarm, Resuscitimer, Mask Restraint system and the EPV100 ventilator.

The company owns and maintains U.S. trademarks for Allied Healthcare Products, Inc., Chemetron, Gomco, Oxequip, Lif-O-Gen, Life Support Products, Timeter, Vacutron and Schuco, its principal trademarks. Registrations for these trademarks are also owned and maintained in countries where such products are sold and such registrations are considered necessary to preserve Company's proprietary rights therein.

## **Environmental and Safety Regulation**

The Company is subject to federal, state and local environmental laws and regulations that impose limitations on the discharge of pollutants into the environment and establish standards for the treatment, storage and disposal of toxic

and hazardous wastes. The Company is also subject to the federal Occupational Safety and Health Act and similar state statutes. From time to time the Company has been involved in environmental proceedings involving clean up of hazardous waste. There are no such material proceedings currently pending. Costs of compliance with environmental, health and safety requirements have not been material to the Company. The Company believes it is in material compliance with all applicable environmental laws and regulations.

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## Competition

The Company has different competitors within each of its product lines. Many of the Company's principal competitors are larger than Allied and the Company believes that most of these competitors have greater financial and other resources. The Company competes primarily on the basis of price, quality and service. The Company believes that it is well positioned with respect to product cost, brand recognition, product reliability, and customer service to compete effectively in each of its markets.

## Employees

At June 30, 2009, the Company had approximately 350 full-time employees. Approximately 226 employees in the Company's principal manufacturing facility located in St. Louis, Missouri, are covered by a collective bargaining agreement that will expire on May 31, 2012.

## Executive Officers of the Registrant

This section provides information regarding the executive officers of the Company who are appointed by and serve at the pleasure of the Board of Directors:

| Name                 | Age | Position   |
|----------------------|-----|--|
| Earl R. Refsland     | 66  | Director, President and Chief Executive Officer <sup>(1)</sup>                           |
| Eldon P. Rosentrater | 55  | Vice President of Administration & Corporate Planning <sup>(2)</sup>                     |
| Robert B. Harris     | 52  | Vice President of Operations <sup>(3)</sup>  |
| Daniel C. Dunn       | 49  | Vice President of Finance, Chief Financial Officer, Secretary & Treasurer <sup>(4)</sup> |

(1) Mr. Refsland has been Director, President and Chief Executive Officer of the Company since September, 1999.

Mr. Rosentrater has been Vice President-Administration/Corporate Planning of the Company since March, 2003.

He previously held the position of Vice President Operations from October 1999 to 2003. Prior to that time, Mr.

(2) Rosentrater held the positions of Assistant to the President from 1998 to 1999; Director of Information Technologies from 1995 to 1998; Director of Business Development from 1993 to 1995 and Group Product Manager from 1989 to 1993.

Mr. Harris has been Vice President Operations since July, 2006. He previously held the positions for Command

(3) Medical Products, Inc. of Vice President Operations from January 2002 to January 2006 and Director of Operations from October 1999 to December 2001. Prior to that time, Mr. Harris held the position of Plant Manager for Sherwood Medical, a subsidiary of Tyco Healthcare from 1997 to 1999.

Mr. Dunn has been Vice President Finance, Chief Financial Officer, Secretary and Treasurer since July, 2001. He

(4) previously held the position of Director of Finance at MetalTek International from 1998 to 2001. Prior to that time, Mr. Dunn held the position of Corporate Controller at Allied Healthcare Products, Inc. from 1994 to 1998.

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## **Item 1A. Risk Factors**

The Company's business, operations and financial condition are subject to various risks and uncertainties. You should carefully consider the risks and uncertainties described below, together with all of the other information in this annual report on Form 10-K and in the company's other filings with the SEC, before making any investment decision with respect to the company's securities. The risks and uncertainties described below may not be the only ones the company faces. Additional risks and uncertainties not presently known by the company or that the company currently deems immaterial may also affect the company's business. If any of these known or unknown risks or uncertainties actually occur or develop, the company's business, financial condition, and results of operations could change.

### **The Company participates in a highly competitive environment.**

The medical device industry is characterized by rapid technological change, changing customer needs and frequent new product introductions. Our products may be rendered obsolete as a result of future innovations. We face intense competition from other manufacturers. Some of our competitors may be larger than we are and may have greater financial, technical, research, marketing, sales, distribution and other resources than we do. We believe that price competition will continue among products developed in our markets. Our competitors may develop or market technologies and products that are more effective or commercially attractive than any we are developing or marketing. Our competitors may succeed in obtaining regulatory approval and introducing or commercializing products before we do. Such developments could have a significant negative effect on our business, financial condition and results of operations. Even if we are able to compete successfully, we may not be able to do so in a profitable manner.

### **Decreased availability or increased costs of raw materials could increase the company's costs of producing its products.**

The company purchases raw materials, fabricated components and services from a variety of suppliers. Raw materials such as brass and plastics are considered key raw materials. The Company believes that its relationships with its suppliers are satisfactory and that alternative sources of supply are readily available. From time to time, however, the prices and availability of these raw materials fluctuate due to global market demands, which could impair the company's ability to procure necessary materials, or increase the cost of such materials. Inflationary and other increases in costs of these raw materials have occurred in the past and may recur from time to time. In addition, freight costs associated with shipping and receiving product and sales are impacted by fluctuations in the cost of oil and gas.

A reduction in the supply or increase in the cost of those raw materials could impact the company's ability to manufacture its products and could increase the cost of production.

### **Changes in third party reimbursement could negatively impact the Company's revenues and profitability.**

The cost of a majority of medical care in the United States is funded by the U.S. Government through the Medicare and Medicaid programs and by private insurance programs, such as corporate health insurance plans. Although the Company does not receive payments for its products directly from these programs, home respiratory care providers and durable medical equipment suppliers, who are the primary customers for several of the Company's products, depend heavily on payments from Medicare, Medicaid and private insurers as a major source of revenues. In addition, sales of certain of the Company's products are affected by the extent of hospital and health care facility construction and renovation at any given time. The federal government indirectly funds a significant percentage of such construction and renovation costs through Medicare and Medicaid reimbursements. In recent years, governmentally

imposed limits on reimbursement to hospitals and other health care providers have impacted spending for services, consumables and capital goods. A material decrease from current reimbursement levels or a material change in the method or basis of reimbursing health care providers is likely to adversely affect future sales of the Company's products.

**Our success depends upon the development of new products and product enhancements, which entails considerable time and expense.**

We place a high priority on the development of new products to add to our product portfolio and on the development of enhancements to our existing products. Product development involves substantial expense and we cannot be certain that a completed product will generate sufficient revenue for our business to justify the

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resources that we devote to research and development related to such product. The time and expense required to develop new products and product enhancements is difficult to predict and we cannot assure you that we will succeed in developing, introducing and marketing new products and product enhancements. Our inability to successfully develop and introduce new or enhanced products on a timely basis or at all, or to achieve market acceptance of such products, could materially impair our business.

**We are dependent on adequate protection of our patent and proprietary rights.**

We rely on patents, trade secrets, trademarks, copyrights, know-how, license agreements and contractual provisions to establish and protect our intellectual property rights. However, these legal means afford us only limited protection and may not adequately protect our rights or remedies to gain or keep any advantages we may have over our competitors.

We cannot assure you that others may not independently develop the same or similar technologies or otherwise obtain access to our technology and trade secrets. Our competitors, many of which have substantial resources and may make substantial investments in competing technologies, may apply for and obtain patents that will prevent, limit, or interfere with our ability to manufacture or market our products. Further, while we do not believe that any of our products or processes interfere with the rights of others, third parties may nonetheless assert patent infringement claims against us in the future.

Costly litigation may be necessary to enforce patents issued to us, to protect trade secrets or know-how we own, to defend us against claimed infringement of the rights of others or to determine the ownership, scope, or validity of our proprietary rights and the rights of others.

Any claim of infringement against us may involve significant liabilities to third parties, could require us to seek licenses from third parties, and could prevent us from manufacturing, selling, or using our products. The occurrence of this litigation or the effect of an adverse determination in any of this type of litigation could have a material adverse effect on our business, financial condition and results of operations.

**Our business of the manufacturing, marketing, and sale of medical devices involves the risk of liability claims and such claims could seriously harm our business, particularly if our insurance coverage is inadequate.**

Our business exposes us to potential product liability claims that are inherent in the testing, production, marketing and sale of medical devices. Like other participants in the medical device market, we are from time to time involved in lawsuits, claims and proceedings alleging product liability and related claims such as negligence. If any current or future product liability claims become substantial, our reputation could be damaged significantly, thereby harming our business. We may be required to pay substantial damage awards as a result of any successful product liability claims. Any product liability claim against us, whether with or without merit, could result in costly litigation, and divert the time, attention, and resources of our management.

As a result of our exposure to product liability claims, we currently carry product liability insurance covering our products with policy limits per occurrence and in the aggregate that we have deemed to be sufficient. Our insurance may not cover certain product liability claims or our liability for any claims may exceed our coverage limits. Therefore, we cannot predict whether this insurance is sufficient, or if not, whether we will be able to obtain sufficient insurance to cover the risks associated with our business or whether such insurance will be available at premiums that are commercially reasonable. In addition, these insurance policies must be renewed annually. Although we have been able to obtain liability insurance, such insurance may not be available in the future on acceptable terms, if at all. A

Our success depends upon the development of new products and product enhancements, which entails considerable

successful claim against us or settlement by us with respect to uninsured liabilities or in excess of our insurance coverage, or our inability to maintain insurance in the future, or any claim that results in significant costs to or adverse publicity against us, could have a material adverse effect on our business, financial condition and results of operations.



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**The Company is subject to substantial domestic and international government regulation, including regulatory quality standards applicable to its manufacturing and quality processes. Failure by the Company to comply with these standards could have an adverse effect on the Company's business, financial condition or results of operations.**

The FDA regulates the approval, manufacturing, and sales and marketing of many of the Company's products in the U.S. Significant government regulation also exists in Canada, Japan, Europe, and other countries in which the Company conducts business. As a device manufacturer, the Company is required to register with the FDA and is subject to periodic inspection by the FDA for compliance with the FDA's Quality System Regulation (QSR) requirements, which require manufacturers of medical devices to adhere to certain regulations, including testing, quality control and documentation procedures. In addition, the federal Medical Device Reporting regulations require the Company to provide information to the FDA whenever there is evidence that reasonably suggests that a device may have caused or contributed to a death or serious injury or, if a malfunction were to occur, could cause or contribute to a death or serious injury. Compliance with applicable regulatory requirements is subject to continual review and is rigorously monitored through periodic inspections by the FDA. In the European Community, the Company is required to maintain certain ISO certifications in order to sell its products and must undergo periodic inspections by notified bodies to obtain and maintain these certifications. Failure to comply with current governmental regulations and quality assurance guidelines could lead to temporary manufacturing shutdowns, product recalls or related field actions, product shortages or delays in product manufacturing. Efficacy or safety concerns, an increase in trends of adverse events in the marketplace, and/or manufacturing quality issues with respect to the Company's products could lead to product recalls or related field actions, withdrawals, and/or declining sales.

**Our products may be subject to product recalls even after receiving FDA clearance or approval, which would harm our reputation and our business.**

The FDA and similar governmental authorities in other countries in which our products are sold, have the authority to request and, in some cases, require the recall of our products in the event of material deficiencies or defects in design or manufacture. A government-mandated or voluntary recall by us could occur as a result of component failures, manufacturing errors or design defects. Any recall of product would divert managerial and financial resources, harm our reputation with our customers and damage our business.

**The Company is exposed to certain credit risks, resulting primarily from customer sales.**

Substantially all of the Company's receivables are due from homecare providers, distributors, hospitals, and contractors. The Company's customers are located throughout the U.S. and around the world. The Company records an estimated allowance for uncollectible amounts based primarily on the Company's evaluation of the payment pattern, financial condition, cash flows, and credit history of its customers as well as current industry and economic conditions. The Company's inability to collect on its trade accounts receivable could substantially reduce the Company's income and have a material adverse effect on its financial condition and results of operations.

**The market price of our common stock may fluctuate widely.**

The market price of our common stock could be subject to significant fluctuations in response to quarter-to-quarter variation in our operating results, announcements of new products or services by us or our competitors, and other events or factors. For example, a shortfall in net sales or net income, or an increase in losses could have an immediate and significant adverse effect on the market price and volume fluctuations that have particularly affected the market prices of many micro and small capitalization companies and that have often been unrelated or disproportionate to the operating performance of these companies. These fluctuations, as well as general economic and market conditions, may adversely affect the market price for our common stock.

**If a natural or man-made disaster strikes our manufacturing facilities, we may be unable to manufacture certain products for a substantial amount of time and our revenue could decline.**

The Company has one principal manufacturing operation. In the event that this facility, located in St. Louis, Missouri, were severely damaged or destroyed as a result of a natural or man-made disaster, the

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Company would be forced to relocate production to other facilities and/or rely on third-party manufacturers. Such an event could have a material adverse effect on the Company's business, results of operations and financial condition. Although we have insurance for damage to our property and the interruption of our business, this insurance may not be sufficient in scope or amount to cover all of our potential losses and may not continue to be available to us on acceptable terms, or at all.

**Requirements associated with the evaluation of internal controls required by Section 404 of the Sarbanes-Oxley Act of 2002 have required and will require significant company resources and management attention.**

The Company is subject to the reporting requirements of federal securities laws, including the Sarbanes-Oxley Act of 2002. Among other requirements, the Sarbanes-Oxley Act requires that the Company maintain effective disclosure controls and procedures and internal control over financial reporting. The Company has, and expects to continue to, expend significant management time and resources maintaining documentation and testing internal control over financial reporting. While management's evaluation as of June 30, 2009 resulted in the conclusion that the Company's internal control over financial reporting was effective as of that date, the Company cannot predict the outcome of testing in future periods. If we are not able to continue to comply with the requirements of Section 404 in a timely manner, we could be subject to scrutiny by regulatory authorities, such as the SEC or the NASDAQ National Market, and the trading price of our stock could decline. Moreover, effective internal controls are necessary for us to produce reliable financial reports and are important in helping us to prevent financial fraud. If we cannot provide reliable financial reports or prevent fraud, our business and operating results could be harmed, investors could lose confidence in our reported financial information, and the trading price of our stock could drop significantly.

**If we are unable to hire or retain key employees, it could have a negative impact on our business.**

Our failure to attract and retain skilled personnel could hinder the management of our business, our research and development, our sales and marketing efforts, and our manufacturing capabilities. However, there is no assurance that we will continue to be able to hire or retain key employees. We compete to hire new employees, and then must train them and develop their skills and competencies. Our operating results could be adversely affected by increased costs due to increased competition for employees, higher employee turnover or increased employee benefit costs. Any unplanned turnover could deplete our institutional knowledge base and erode our competitive advantage.

**Item 1B. Unresolved Staff Comments**

Not applicable.

**Item 2. Properties**

The Company's headquarters are located in St. Louis, Missouri and the Company maintains manufacturing facilities in Missouri and New York. Set forth below is certain information with respect to the Company's manufacturing facilities at June 30, 2009.

Location

Activities/Products

If a natural or man-made disaster strikes our manufacturing facilities, we maybe unable to manufacture certain prod

|                               | Square<br>Footage<br>(Approximate) | Owned/<br>Leased |  |
|-------------------------------|------------------------------------|------------------|--|
| St. Louis, Missouri           | 270,000                            | Owned            | Headquarters; medical gas equipment;<br>respiratory care products; emergency medical<br>products |
| Stuyvesant Falls, New<br>York | 30,000                             | Owned            | CO2 absorbent  |

In addition, the Company owns a 16.8-acre parcel of undeveloped land in Stuyvesant Falls, New York.

### **Item 3. *Legal Proceedings***

Product liability lawsuits are filed against the Company from time to time for various injuries alleged to have resulted from defects in the manufacture and/or design of the Company's products. Any such proceedings that are currently pending are not expected to have a material adverse effect on the Company. The Company maintains comprehensive general liability insurance coverage which it believes to be adequate for the continued operation of its business, including coverage of product liability claims.

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In addition, from time to time the Company's products may be subject to product recalls in order to correct design or manufacturing flaws in such products. The Company intends to continue to conduct business in such a manner as to avert any FDA action seeking to interrupt or suspend manufacturing or require any recall or modification of products.

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

None

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Allied Healthcare Products, Inc. trades on the NASDAQ National Market under the symbol AHPI. As of September 14, 2009, there were 180 record owners of the Company's Common Stock. The following tables summarize information with respect to the high and low closing prices for the Company's Common Stock as listed on the NASDAQ National market for each quarter of fiscal 2009 and 2008, respectively. The Company currently does not pay, and in the most recent fiscal years has not paid, any dividend on its Common Stock.

**Common Stock Information**

| 2009              | High   | Low    | 2008              | High   | Low    |
|-------------------|--------|--------|-------------------|--------|--------|
| September quarter | \$7.00 | \$5.00 | September quarter | \$6.76 | \$5.05 |
| December quarter  | \$6.19 | \$2.85 | December quarter  | \$7.25 | \$5.85 |
| March quarter     | \$4.50 | \$2.83 | March quarter     | \$7.25 | \$6.00 |
| June quarter      | \$5.68 | \$3.00 | June quarter      | \$7.27 | \$6.00 |

Information concerning securities authorized for issuance under equity compensation plans is incorporated by reference to the Company's proxy statement for the 2009 annual meeting of shareholders.

**Item 6. Selected Consolidated Financial Data**

| <i>(In thousands, except per share data)</i>                   | 2009       | 2008     | 2007     | 2006     | 2005     |
|--|------------|----------|----------|----------|----------|
| <b>Year ended June 30,</b>                                     |            |          |          |          |          |
| <b>Consolidated Statement of Operations Data</b>               |            |          |          |          |          |
| Net sales  | \$52,073   | \$56,364 | \$56,501 | \$57,546 | \$56,120 |
| Cost of sales  | 40,273     | 43,006   | 42,028   | 43,293   | 41,669   |
| Gross profit   | 11,800     | 13,358   | 14,473   | 14,253   | 14,451   |
| Impairment of goodwill <sup>(2)</sup>                          | 15,980     |          |          |          |          |
| Selling, general and administrative expenses                   | 13,042     | 12,085   | 12,052   | 12,113   | 11,843   |
| Income (loss) from operations                                  | (17,222 )  | 1,273    | 2,421    | 2,140    | 2,608    |
| Interest expense   |            | 20       |          |          | 123      |
| Interest income  | (60 )      | (138 )   | (111 )   | (53 )    |          |
| Other, net   | 50         | 60       | (24 )    | 37       | 43       |
| Income (loss) before provision for (benefit from) income taxes | (17,212 )  | 1,331    | 2,556    | 2,156    | 2,442    |
| Provision for (benefit from) income taxes <sup>(1)</sup>       | (450 )     | 449      | 914      | 507      | 101      |
| Net income (loss)  | (\$16,762) | \$882    | \$1,642  | \$1,649  | \$2,341  |
| Basic earnings (loss) per share                                | (\$2.12 )  | \$0.11   | \$0.21   | \$0.21   | \$0.30   |
| Diluted earnings (loss) per share                              | (\$2.12 )  | \$0.11   | \$0.20   | \$0.20   | \$0.29   |
| Basic weighted average common shares outstanding               | 7,899      | 7,884    | 7,876    | 7,841    | 7,822    |

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|  |       |       |       |       |       |
|--|-------|-------|-------|-------|-------|
| Diluted weighted average common shares outstanding | 7,899 | 8,120 | 8,085 | 8,066 | 8,081 |
|--|-------|-------|-------|-------|-------|

| (In thousands)<br><b>June 30,</b><br>Consolidated Balance Sheet Data | 2009      | 2008      | 2007      | 2006      | 2005      |
|--|-----------|-----------|-----------|-----------|-----------|
| Working capital  | \$ 16,987 | \$ 18,291 | \$ 17,269 | \$ 14,644 | \$ 12,250 |
| Total assets   | 32,297    | 52,258    | 51,318    | 49,330    | 46,097    |
| Stockholders' equity   | 26,685    | 43,339    | 42,485    | 40,660    | 38,862    |

(1) See Note 5 to the June 30, 2009 Consolidated Financial Statements for further discussion of the Company's effective tax rate.

(2) See Note 13 to the June 30, 2009 Consolidated Financial Statements for further discussion.

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Allied manufactures and markets respiratory products, including respiratory care products, medical gas equipment and emergency medical products. Set forth below is certain information with respect to amounts and percentages of net sales attributable to respiratory care products, medical gas equipment and emergency medical products for the fiscal years ended June 30, 2009, 2008, and 2007.

| Year ended June 30,        | Dollars in thousands |                      |   |
|----------------------------|----------------------|----------------------|---|
|                            | 2009                 |                      |   |
|                            | Net Sales            | % of Total Net Sales |   |
| Respiratory care products  | \$ 12,303            | 23.6                 | % |
| Medical gas equipment      | 29,656               | 57.0                 | % |
| Emergency medical products | 10,114               | 19.4                 | % |
| Total                      | \$ 52,073            | 100.0                | % |

| Year ended June 30,        | Dollars in thousands |                      |   |
|----------------------------|----------------------|----------------------|---|
|                            | 2008                 |                      |   |
|                            | Net Sales            | % of Total Net Sales |   |
| Respiratory care products  | \$ 14,248            | 25.3                 | % |
| Medical gas equipment      | 30,744               | 54.5                 | % |
| Emergency medical products | 11,372               | 20.2                 | % |
| Total                      | \$ 56,364            | 100.0                | % |

| Year ended June 30,        | Dollars in thousands |                      |   |
|----------------------------|----------------------|----------------------|---|
|                            | 2007                 |                      |   |
|                            | Net Sales            | % of Total Net Sales |   |
| Respiratory care products  | \$ 13,899            | 24.6                 | % |
| Medical gas equipment      | 32,775               | 58.0                 | % |
| Emergency medical products | 9,827                | 17.4                 | % |
| Total                      | \$ 56,501            | 100.0                | % |

The following table sets forth, for the fiscal periods indicated, the percentage of net sales represented by the various income and expense categories reflected in the Company's consolidated statement of operations.

| Year ended June 30, | 2009    | 2008    | 2007    |
|---------------------|---------|---------|---------|
| Net sales           | 100.0 % | 100.0 % | 100.0 % |
| Cost of sales       | 77.3    | 76.3    | 74.4    |



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|   |          |       |       |
|---|----------|-------|-------|
| Gross profit                                    | 22.7     | 23.7  | 25.6  |
| Selling, general and administrative expenses    | 25.0     | 21.4  | 21.3  |
| Impairment of goodwill                          | 30.7     | -     | -     |
| Income (loss) from operations                   | (33.1 )  | 2.3   | 4.3   |
| Interest expense                                | 0.0      | 0.0   | 0.0   |
| Interest income                                 | 0.1      | 0.2   | 0.2   |
| Other, net                                      | 0.1      | 0.1   | 0.0   |
| Income (loss) before provision for income taxes | (33.1 )  | 2.4   | 4.5   |
| Provision for (benefit from) income taxes       | (0.9 )   | 0.8   | 1.6   |
| Net income (loss)                               | (32.2 )% | 1.6 % | 2.9 % |

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## **Critical Accounting Policies**

In preparing financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company evaluates estimates and judgments on an ongoing basis, including those related to bad debts, inventory valuations, property, plant and equipment, intangible assets, income taxes, and contingencies and litigation. Estimates and judgments are based on historical experience and on various other factors that may be reasonable under the circumstances. Actual results may differ from these estimates. The following areas are considered to be the Company's most significant accounting policies:

### **Revenue recognition:**

Revenue is recognized for all sales, including sales to agents and distributors, at the time products are shipped and title has transferred, provided that a purchase order has been received or a contract executed, there are not uncertainties regarding customer acceptance, the sales price is fixed and determinable and collectability is reasonably assured. Sales discounts, returns and allowances are included in net sales, and the provision for doubtful accounts is included in selling, general and administrative expenses. Additionally, it is the Company's practice to include revenues generated from freight billed to customers in net sales with corresponding freight expense included in cost of sales in the consolidated statement of operations.

The sales price is fixed by Allied's acceptance of the buyer's firm purchase order. The sales price is not contingent, or subject to additional discounts. Allied's standard shipment terms are F.O.B. shipping point as stated in Allied's Terms and Conditions of Sale. The customer is responsible for obtaining insurance for and bears the risk of loss for product in-transit. Additionally, sales to customers do not include the right to return merchandise without the prior consent of Allied. In those cases where returns are accepted, product must be current and restocking fees must be paid by the respective customer. A provision has been made for estimated sales returns and allowances. These estimates are based on historical analysis of credit memo data and returns.

Allied does not provide installation services for its products. Most products shipped are ready for immediate use by the customer. The Company's in-wall medical system components, central station pumps and compressors, and headwalls do require installation by the customer. These products are typically purchased by a third-party contractor who is ultimately responsible for installation services. Accordingly, the customer purchase order or contract does not require customer acceptance of the installation prior to completion of the sale transaction and revenue recognition. Allied's standard payment terms are net 30 days from the date of shipment, and payment is specifically not subject to customer inspection of acceptance, as stated in Allied's Terms and Conditions of Sale. The buyer becomes obligated to pay Allied at the time of shipment. Allied requires credit applications from its customers and performs credit reviews to determine the creditworthiness of new customers. Allied requires letters of credit, where warranted, for international transactions. Allied also protects its legal rights under mechanics lien laws when selling to contractors.

Allied does offer limited warranties on its products. The standard warranty period is one year. The Company's cost of providing warranty service for its products for the years ended June 30, 2009, June 30, 2008, and June 30, 2007 was \$166,651, \$62,954, and \$118,967, respectively. The related liability for warranty service amounted to \$104,157 and \$86,343 at June 30, 2009 and 2008, respectively.

**Inventory reserve for obsolete and excess inventory:**

Inventory is recorded net of a reserve for obsolete and excess inventory which is determined based on an analysis of inventory items with no usage in the preceding year and for inventory items for which there is greater than two years usage on hand. This analysis considers those identified inventory items to determine, in management's best estimate, if parts can be used beyond one year, if there are alternate uses or at what values such parts may be disposed for. At June 30, 2009 and 2008, inventory is recorded net of a reserve for obsolete and excess inventory of \$1.3 million.

**Income taxes:**

The Company accounts for income taxes under SFAS No. 109, Accounting for Income Taxes. Under SFAS No. 109, the deferred tax provision is determined using the liability method, whereby deferred tax assets and liabilities are recognized based upon temporary differences between the financial statement and

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income tax bases of assets and liabilities using presently enacted tax rates. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

**Accounts receivable net of allowances:**

Accounts receivable are recorded net of an allowance for doubtful accounts, which is determined based on an analysis of past due accounts including accounts placed with collection agencies, and an allowance for returns and credits, which is based on historical analysis of credit memo data and returns. At June 30, 2009 and 2008, accounts receivable is recorded net of allowances of \$0.3 million.

**Goodwill:**

Goodwill initially arises from business acquisitions and represents the value of unidentifiable intangibles in an acquired business. Goodwill is then evaluated at least annually for impairment in accordance with SFAS No. 142 Goodwill and Other Intangible Assets.

At June 30, 2008 the Company had goodwill of \$16.0 million. As a result of impairment testing as of June 30, 2009 the Company wrote down all of its goodwill so that at June 30<sup>th</sup>, 2009 the Company had zero goodwill. This impairment reflected the deteriorating market conditions the Company faces and lower prospects for earnings and cash flow. The amount of the impairment was determined in accordance with SFAS 142 Goodwill and Other Intangibles, which compares carrying value to the estimated fair value of assets and liabilities. The Company conducts a formal impairment test of goodwill annually at June 30<sup>th</sup> and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company below its carrying value. The annual impairment test did not indicate an impairment of goodwill at June 30, 2008, or 2007.

Allied operates as one reporting unit and prepares its annual goodwill impairment test in that manner. None of the Company's product lines constitute a business, as that term is defined in Emerging Issues Task Force (EITF) Issue 98-3. Most of its products are produced in one facility, and Allied does not produce separate financial statements for any part of its business.

At June 30, 2008 the Company had goodwill of \$16.0 million, resulting from the excess of the purchase price over the fair value of net assets acquired in business combinations. The Company completed its annual goodwill impairment test during the fourth quarter of the fiscal year ended June 30, 2009. Due to a general slow down in orders as a result of the current recession, operating profits and cash flows were lower than expected during fiscal 2009. Based on that trend, management revised its earnings forecast for fiscal 2009. In addition, during 2009 the stock traded below book value, in part due to the global economic downturn's impact on Company performance and the turmoil in the equity markets.

In accordance with SFAS 142, a two step process is used to test for goodwill impairment. The first step is to determine if there is an indication of impairment by comparing the estimated fair value of the Company to its carrying value including existing goodwill. Goodwill is considered impaired if the carrying value of the Company exceeds the estimated fair value. Upon indication of impairment, a second step is performed to determine the amount of the impairment by comparing the implied fair value of the Company's goodwill with its carrying value.

To estimate the fair value of the Company for step one, the Company utilized a combination of income and market approaches. The income approach, specifically a discounted cash flow methodology, included assumptions for, among others, forecasted revenues, gross profit margins, operating profit margins, working capital cash flow, perpetual growth rates and long term discount rates, all of which requires significant judgments by management. These

assumptions take into account the current recessionary environment and its impact on the Company's business. In addition, the Company utilized a discount rate appropriate to compensate for its earning risk relative the equity markets as a whole. The Company considered historical industry transactions in arriving at an appropriate control premium to identify the value of the company to market participants for the market approach.

The results of step one indicated that the Company's goodwill was substantially impaired. A step two analysis was performed to the extent necessary to determine that all of the Company's goodwill was impaired. Accordingly, the Company wrote off the entire goodwill balance and recorded an impairment charge of \$16.0 million. As a result, at June 30, 2009 the Company had a goodwill balance of zero. The goodwill impairment

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charge is non-cash in nature and does not affect the company's liquidity, cash flows from operating activities or debt covenants and will not have a material impact on future operations.

In accordance with SFAS 144, *Accounting for Impairment or Disposal of Long-Lived Assets*, the Company also evaluated the recoverability of its long-lived assets. Based upon this evaluation, the Company determined that there was no impairment of these assets.

**Self-insurance:**

The Company maintains a self-insurance program for a portion of its health care costs. Self-insurance costs are accrued based upon the aggregate of the liability for reported claims and the estimated liability for claims incurred but not reported. As of June 30, 2009 and 2008, the Company had \$395,000 and \$300,000 respectively, of accrued liabilities related to health care claims. In order to establish the self-insurance reserves, the Company utilized actuarial estimates of expected claims based on analyses of historical data.

**Significant Factors Affecting Past and Future Operating Results**

On August 27, 2004, Allied Healthcare Products, Inc. (Allied) entered into an agreement with Abbott Laboratories (Abbott) pursuant to which Allied agreed to cease production of its product Baralyme®, and to effect the withdrawal of Baralyme® product held by distributors. The agreement permits Allied to pursue the development of a new carbon dioxide absorbent product. Baralyme®, a carbon dioxide absorbent product, has been used safely and effectively in connection with inhalation anesthetics since its introduction in the 1920s. In recent years, the number of inhalation anesthetics has increased, giving rise to concerns regarding the use of Baralyme® in conjunction with these newer inhalation anesthetics if Baralyme® has been allowed, contrary to recommended practice, to become desiccated. The agreement also provides that, for a period of eight years, Allied will not manufacture, distribute, promote, market, sell, commercialize or donate any Baralyme® product or similar product based upon potassium hydroxide and will not develop or license any new carbon dioxide absorbent product containing potassium hydroxide.

In consideration of the foregoing, Abbott agreed to pay Allied an aggregate of \$5,250,000 of which \$1,530,000 was paid on September 30, 2004 and the remainder payable in four equal annual installments of \$930,000 due on July 1, 2005 through July 1, 2008. The last installment due on July 1, 2008 was received by Allied on June 19, 2008.

The payments received from Abbott are being recognized into income, as net sales, over the eight-year term of the agreement. Allied has no further obligations under this agreement which would require the Company to repay these amounts or otherwise impact this accounting treatment. During the year ended June 30, 2009, \$688,200 was recognized into income as net sales.

A reconciliation of deferred revenue resulting from the agreement with Abbott, with the amounts received under the agreement, and amounts recognized as net sales for fiscal years 2009 and 2008 is as follows:

|   | Twelve Months ended<br>June 30, |              |
|---|---------------------------------|--------------|
|   | 2009                            | 2008         |
| Beginning balance                         | \$ 2,867,500                    | \$ 2,402,500 |
| Payment Received from Abbott Laboratories |                                 | 930,000      |
| Revenue recognized as net sales           | (688,200 )                      | (465,000 )   |

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|  |              |              |
|--|--------------|--------------|
|  | 2,179,300    | 2,867,500    |
| Less Current portion of deferred revenue | (688,200 )   | (690,000 )   |
|  | \$ 1,491,100 | \$ 2,177,500 |

In 2004, Allied's sales of Baralyme® were approximately \$2.0 million and contributed approximately \$0.6 million in pre-tax earnings and cash flow from operations. The majority of the \$5,250,000 Allied has received from Abbott will be recognized into income over the eight-year term of the agreement. The net cash flow realized by Allied under the agreement with Abbott is substantially equivalent to the net cash flow Allied would have expected to realize from continued manufacture and sales of Baralyme® during the initial five years of the period.

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## **Fiscal 2009 Compared to Fiscal 2008**

The Company had a loss of \$17.2 million before taxes for fiscal 2009, compared to income of \$1.3 million before taxes for fiscal 2008. The Company recorded an income tax benefit of \$0.4 million in fiscal 2009, compared to an income tax provision of \$0.4 million in fiscal 2008. Due to the non-deductibility of the goodwill impairment charge for federal income tax purposes, the 2009 tax benefit was not affected.

For further discussion of the Company's income tax calculation please refer to Note 5 of the Notes to Consolidated Financial Statements section included in this Form 10-K.

Financial results for fiscal 2009 were adversely impacted by the write down of \$16.0 million in goodwill. The write down resulted from the required annual impairment review of its goodwill at June 30, 2009, which took into consideration the declining economic environment and declining profitability. For further discussion of the Company's goodwill impairment calculation please refer to the Critical Accounting Policies Goodwill section above.

Net sales for fiscal 2009 of \$52.1 million were \$4.3 million or 7.6% less than net sales of \$56.4 million in fiscal 2008.

Domestically, sales decreased by \$3.7 million dollars. Internationally, sales decreased by \$0.6 million. International business is dependent upon hospital construction projects, and the development of medical facilities in those regions in which the Company operates. Domestic sales for fiscal 2009 include approximately \$0.8 million for the recognition into sales of payments resulting from the agreement with Abbott Laboratories, as discussed below. For 2008, domestic sales included approximately \$1.7 million for the recognition into sales of payments resulting from the agreement with Abbott Laboratories.

The decrease in net sales for the year is primarily the result of the worldwide recession. By and large, the Company's products are considered durable goods. The Company believes that the purchase of equipment and durable goods and the purchase of equipment by hospitals and municipalities have been cut radically as a short term measure to meet budgets and conserve cash. Orders for the Company's products for the year ended June 30, 2009 of \$49.5 million were \$4.9 million or 9.0% lower than orders for the year ended June 30, 2008 of \$54.4 million. Customer purchase order releases for the year ended June 30, 2009 of \$49.6 million were \$4.2 million or 7.8% lower than customer purchase order releases of \$53.8 million from the prior fiscal year.

Sales for the year ended June 30, 2009 included \$688,000 for the recognition into sales of payments resulting from the agreement with Abbott Laboratories to cease production and distribution of Baralyme®. Sales for the year ended June 30, 2009 also included recognition as sales of \$99,000 in reimbursement by Abbott Laboratories in product development cost to pursue development of new carbon dioxide absorption product as a result of the agreement to cease production and distribution of Baralyme®. In total, domestic sales for 2009 included approximately \$787,000 for recognition into sales of payments resulting from the agreement with Abbott Laboratories.

By comparison, sales for the year ended June 30, 2008 included \$465,000 for the recognition into sales of payments resulting from the agreement with Abbott Laboratories to cease production and distribution of Baralyme® and \$1,196,000 in reimbursement by Abbott Laboratories in product development cost to pursue development of new carbon dioxide absorption product to replace Baralyme®.

Allied continues to sell Carbolime®, a carbon dioxide absorbent with a different formulation than Baralyme®. For the year ended June 30, 2009 the Company had carbon dioxide absorbent sales of Carbolime®, of \$1.8 million dollars, compared with \$1.9 million for the year ended June 30, 2008.



Respiratory care products sales in fiscal 2009 of \$12.3 million were \$1.9 million, or 13.4% lower than sales of \$14.2 million in the prior year. Included in the sales for respiratory care products is an approximately \$1.0 million decrease in the amount recognized resulting from the agreement to cease the production and distribution of Baralyme®. The amount recognized as sales decreased to approximately \$0.7 million or \$1.0 million less than in the prior year.

Respiratory care products also include the Company's efforts in the Homecare market. The Company continues to develop systems and personnel to improve our telemarketing efforts, has increased inventory levels to improve customer service levels, and continues to emphasize measures to reduce cost.

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Medical gas equipment sales, which include construction products, of \$29.7 million in fiscal 2009 were \$1.0 million, or 3.3% lower than prior year levels of \$30.7 million. Internationally, sales of Medical gas equipment in fiscal 2009 were \$0.8 million less than in the prior year. The remainder of the decrease in sales, of \$0.2 million, took place in the domestic market. The Company does not believe this decrease in sales represents a loss of market share.

Emergency medical product sales in fiscal 2009 of \$10.1 million were \$1.3 million or 11.4% lower than fiscal 2008 sales of \$11.4 million. International sales of Emergency medical products were unchanged from the prior year while domestic sales decreased by \$1.3 million. Also, orders for the Company's Emergency Products were \$1.2 million lower than the prior year. The Company believes that demand for these products, which are largely consumed by local agencies, was impacted by economic conditions as states and municipalities struggled with decreased tax revenues.

International sales, which are included in the product lines discussed above, decreased \$0.7 million, or 6.5%, to \$10.1 million in fiscal 2009 compared to sales of \$10.8 million in fiscal 2008. As discussed above, the Company's international shipments are dependent on hospital construction projects and the expansion of medical care in those regions. In fiscal 2009, international shipments of Medical Gas equipment, including construction products, decreased by \$0.8 million dollars. This decrease was partially offset by an increase of \$48,000 in the sale of Emergency care products and by a \$142,000 increase in the sale of Respiratory care products. The Company believes order declines in South America and Southeast Asia, and other regions are the result of the current recession.

Gross profit in fiscal 2009 was \$11.8 million, or 22.6% of sales, compared to a gross profit of \$13.4 million, or 23.7% of sales in fiscal 2008. Lower production levels result in less effective utilization of the Company's manufacturing capacity and the fixed expenses associated with that capacity. In addition, the cost of providing medical coverage to its employees increased approximately \$0.3 million in fiscal 2009 over fiscal 2008. Cost of sales for the year ended June 30, 2009 includes approximately \$0.1 million in cost incurred in product development cost to pursue development of a new carbon dioxide absorption product as a result of the agreement with Abbott Laboratories to cease production and distribution of Baralyme®. Cost of sales for the year ended June 30, 2008 includes approximately \$0.6 million in cost incurred in product development cost to pursue development of a new carbon dioxide absorption product.

The Company invested \$1.5 million in capital expenditures in fiscal 2009, \$1.1 million in fiscal 2008, and \$0.6 million in fiscal 2007 for manufacturing equipment and computer systems, which continue to decrease production costs and improve efficiencies for several product lines. The Company continues to control cost and actively pursue methods to reduce its costs.

Selling, General, and Administrative (SG&A) expenses for fiscal 2009 were \$13.0 million, compared to SG&A expenses of \$12.1 million in fiscal 2008. Salaries and benefits increased by \$0.8 million from the prior year primarily due to open employee positions in the prior fiscal year and normal increases in the cost of fringe benefits. There have not been changes in staffing levels over the prior year. Also, outside services increased approximately \$0.1 million primarily for the testing of the Company's new EPV100 and MCV ventilators designed to meet the needs of the mass casualty and pandemic markets. Additionally, legal expenses increased by approximately \$0.1 million, as a result of product liability claims. Selling, general and administrative expenses also include approximately \$0.2 million in product development cost for the new carbon dioxide absorption product being developed. In the prior year all development cost for this product were reimbursed. These increases have been partially offset by a \$0.1 million decrease in recruiting expenses and a \$0.1 million decrease in auditing and accounting professional fees from the prior year as a result of the IRS examination of the Company's U.S. income tax returns for the fiscal years ended June 30, 2005 and 2006, which occurred during fiscal year 2008.

Interest income in fiscal 2009 was \$60,000 compared to interest income of \$138,000 in fiscal 2008.

Net loss in fiscal 2009 was \$16.8 million or \$2.12 per basic and diluted earnings per share, down from net income of \$0.9 million, or \$0.11 per basic and diluted earnings per share in fiscal 2008. In 2009, the weighted number of shares used in the calculation of basic and diluted earnings per share was 7,898,782. In

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2008, the weighted number of shares used in the calculation of basic earnings per share was 7,883,659 and the weighted number of shares used in the calculation of diluted earnings per share was 8,119,776.

## **Fiscal 2008 Compared to Fiscal 2007**

The Company had income of \$1.3 million before taxes for fiscal 2008, compared to income of \$2.6 million before taxes for fiscal 2007. The Company recorded an income tax provision of \$0.4 million in fiscal 2008, compared to an income tax provision of \$0.9 million in fiscal 2007. For further discussion of the Company's income tax calculation please refer to Note 5 of the Notes to Consolidated Financial Statements section included in this Form 10-K.

Net income in fiscal 2008 was \$0.9 million or \$0.11 per basic and diluted earnings per share, down from net income of \$1.6 million, or \$0.21 per basic and \$0.20 per diluted earnings per share in fiscal 2007. In 2008, the weighted number of shares used in the calculation of basic earnings per share was 7,883,659 and the weighted number of shares used in the calculation of diluted earnings per share was 8,119,776. In 2007, the weighted number of shares used in the calculation of basic earnings per share was 7,875,982 and the weighted number of shares used in the calculation of diluted earnings per share was 8,085,375.

Net sales for fiscal 2008 of \$56.4 million were \$0.1 million or 0.2% less than net sales of \$56.5 million in fiscal 2007.

Domestically, sales decreased by \$0.7 million dollars. Internationally, sales increased by \$0.6 million dollars.

International business is dependent upon hospital construction projects, and the development of medical facilities in those regions in which the Company operates. Domestic sales for fiscal 2008 include approximately \$1.7 million for the recognition into sales of payments resulting from the agreement with Abbott Laboratories, as discussed below. For 2007, domestic sales included approximately \$1.0 million for the recognition into sales of payments resulting from the agreement with Abbott Laboratories.

The decrease in net sales for 2008 was primarily the result of shipping performance. Orders for the Company's products for the year ended June 30, 2008 of \$54.4 million were \$0.4 million or 0.7% higher than orders for the year ended June 30, 2007 of \$54.0 million. Customer purchase order releases of \$53.8 million were unchanged from fiscal 2007. However, slight delays in production did lead to a slight decrease in sales for the year.

Sales for the year ended June 30, 2008 included \$465,000 for the recognition into sales of payments resulting from the agreement with Abbott Laboratories to cease production and distribution of Baralyme®. Sales for the year ended June 30, 2008 also included recognition as sales of \$1,196,000 reimbursement by Abbott Laboratories in product development cost to pursue development of new carbon dioxide absorption product as a result of the agreement to cease production and distribution of Baralyme®. In total, domestic sales for 2008 included approximately \$1,661,000 for recognition into sales of payments resulting from the agreement with Abbott Laboratories.

By comparison, sales for the year ended June 30, 2007 included \$465,000 for the recognition into sales of payments resulting from the agreement with Abbott Laboratories to cease production and distribution of Baralyme® and \$584,000 reimbursement by Abbott Laboratories in product development cost to pursue development of new carbon dioxide absorption product to replace Baralyme®.

Allied continues to sell Carbolime®, a carbon dioxide absorbent with a different formulation than Baralyme®. For the year ended June 30, 2008 the Company had carbon dioxide absorbent sales of Carbolime®, of \$1.9 million dollars, compared with \$2.0 million for the year ended June 30, 2007 and \$2.0 million for the year ended June 30, 2006.

Respiratory care products sales in fiscal 2008 of \$14.2 million were \$0.3 million, or 2.2% higher than sales of \$13.9 million in the prior year. Included in the sales for respiratory care products is an approximately \$0.7 million increase in the amount recognized resulting from the agreement to cease the production and distribution of Baralyme®. The amount recognized as sales increased to approximately \$1.7 million or \$0.7 million more than in the prior year. Respiratory care products also include the Company's efforts in the Homecare market. The Company continues to develop systems and personnel to improve our telemarketing efforts, has increased inventory levels to improve customer service levels, and continues to emphasize measures to reduce cost.

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Medical gas equipment sales, which include construction products, of \$30.7 million in fiscal 2008 were \$2.1 million, or 6.4% lower than prior year levels of \$32.8 million. Internationally, sales of Medical gas equipment in fiscal 2008 were \$0.3 million more than in the prior year. The decrease in sales, of \$2.3 million, took place in the domestic market. Price competition in this market is significant, however, the Company does not believe this represents a loss of market share.

Emergency medical product sales in fiscal 2008 of \$11.4 million were \$1.6 million or 16.3% higher than fiscal 2007 sales of \$9.8 million. International sales of Emergency medical products increased by \$0.5 million, while domestic sales increased by \$1.1 million. Also, orders for the Company's Emergency Products were \$1.1 million higher than the prior year. The Company believes that demand for these products have been favorably impacted by emergency preparedness, including Federal Homeland Security funding for emergency responders.

International sales, which are included in the product lines discussed above, increased \$0.6 million, or 5.9%, to \$10.8 million in fiscal 2008 compared to sales of \$10.2 million in fiscal 2007. As discussed above, the Company's international shipments are dependent on hospital construction projects and the expansion of medical care in those regions. In fiscal 2008, international shipments of Medical Gas equipment, including construction products, increased by \$0.3 million dollars. The increase in international sales also included a \$0.5 million increase in the sale of Emergency care products. These increases were offset by a \$0.2 million decrease in the sale of Respiratory care products.

Gross profit in fiscal 2008 was \$13.4 million, or 23.7% of sales, compared to a gross profit of \$14.5 million, or 25.6% of sales in fiscal 2007. Increases in material cost negatively impacted gross margins during fiscal 2008. Material cost was approximately 2.0% higher than in the prior year. Labor costs are approximately 3.8% higher than in the prior year due to contractual increases with the bargaining unit. The decrease in gross profit as a percent of sales was also partially due to lower production levels versus the prior year related to a decrease in inventory levels for the year. Lower production levels result in less effective utilization of the Company's manufacturing capacity and the fixed expenses associated with that capacity. Cost of sales for the year ended June 30, 2007 includes approximately \$0.6 million in cost incurred in product development cost to pursue development of a new carbon dioxide absorption product as a result of the agreement with Abbott Laboratories to cease production and distribution of Baralyme®. Cost of sales for the year ended June 30, 2008 includes approximately \$1.0 million in cost incurred in product development cost to pursue development of a new carbon dioxide absorption product.

The Company invested \$1.1 million in capital expenditures in fiscal 2008, \$0.6 million in fiscal 2007, and \$1.0 million in fiscal 2006 for manufacturing equipment and computer systems, which continue to decrease production costs and improve efficiencies for several product lines.

Selling, General, and Administrative (SG&A) expenses for fiscal 2008 were \$12.1 million, unchanged from SG&A expenses of \$12.1 million in fiscal 2007. Legal expenses decreased by approximately \$0.2 million, as open product liability claims were settled in the prior year.

Interest income in fiscal 2008 was \$0.1 million, unchanged from fiscal 2007.

## **Financial Condition, Liquidity and Capital Resources**

The following table sets forth selected information concerning Allied's financial condition at June 30:

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| Dollars in thousands    | 2009      | 2008      | 2007      |
|-------------------------|-----------|-----------|-----------|
| Cash & cash equivalents | \$ 1,943  | \$ 6,149  | \$ 3,639  |
| Working Capital         | \$ 16,987 | \$ 18,291 | \$ 17,269 |
| Total Debt              | \$        | \$        | \$        |
| Current Ratio           | 4.36:1    | 3.71:1    | 3.50:1    |

The Company's working capital was \$17.0 million at June 30, 2009 compared to \$18.3 million at June 30, 2008. Income taxes receivable increased \$0.9 million and inventory increased by \$0.6 million, while accounts payable decreased \$1.0 million, accrued liabilities decreased \$0.6 million and deferred income taxes decreased \$0.2 million.

During fiscal 2009, these increases in working capital were offset by a decrease of

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\$4.2 million in cash and cash equivalents and other current assets decreased \$0.1 million. Accounts receivable decreased to \$6.2 million at June 30, 2009, down \$0.3 million from \$6.4 million at June 30, 2008. Accounts receivable as measured in days sales outstanding ( DSO ) increased to 43 DSO up from 34 DSO in the prior year. Inventory increased during 2009 as the company invested in finished goods and components for its new line of pandemic and mass casualty ventilators. Accounts payable decreased in 2009 primarily due to lower inventory purchases in the fourth quarter of 2009.

The net decrease in cash for the fiscal year ended June 30, 2009 was \$4.2 million. The net increase in cash for the fiscal year ended June 30, 2008 was \$2.5 million. Net cash used in operating activities was \$2.7 million for fiscal 2009 compared to net cash provided by operating activities of \$3.7 for fiscal 2008.

Cash flows used in operating activities for the fiscal year ended June 30, 2009 consisted of a net loss of \$16.8 million, supplemented by \$1.3 million in non-cash charges to operations for amortization and depreciation. The net loss was also offset by a \$16.0 million non-cash charge to operations for the impairment of goodwill. Cash flow was used to make capital expenditures of \$1.5 million.

Cash flows provided by operating activities for the fiscal year ended June 30, 2008 consisted of a net income of \$0.9 million, supplemented by \$1.2 million in non-cash charges to operations for amortization and depreciation. Cash flow was used to make capital expenditures of \$1.1 million.

The Company has entered into a credit facility arrangement with Bank of America, the successor in interest to LaSalle Bank National Association (the Bank ). The credit facility was amended on September 26, 2002, September 26, 2003, August 25, 2004, September 1, 2005, and September 30, 2008.

Under the terms of the credit facility, the Company is required to be in compliance with certain financial covenants pertaining to stockholders' equity, capital expenditures and net income. Additionally, the terms of the credit facility restrict the Company from the payment of dividends on any class of its stock. At June 30, 2009, the Company was in violation of its fixed charge coverage ratio covenant on the credit agreement. The Company has no outstanding amounts under the credit facility. Based on its discussions with the Bank and other financial institutions, the Company believes it will be able to negotiate an acceptable waiver and amendment with the Bank or to procure a replacement credit facility with another lender. Even if this were not possible, the Company does not anticipate the technical default under the credit facility to materially impact its liquidity.

The revolving credit facility provides for a borrowing base of 80% of eligible accounts receivable plus the lesser of 50% of eligible inventory or \$7.0 million, subject to reserves as established by the Bank. The maximum borrowing under the revolving credit facility is \$10 million. At June 30, 2009, \$10 million was available under the revolving credit facility. However, as of September 25, 2009, the Company does not have any availability under the revolving credit facility due to the financial covenant violations discussed above. As a result of an amendment made on September 30, 2008, the credit facility matures on September 1, 2010. Borrowings under the facility accrue interest at a variable rate equal to the Bank's prime rate. The credit facility calls for a commitment fee payable quarterly based on the average daily unused portion of the revolving credit facility. This commitment fee is 0.25% if the Company's ratio of funded debt to EBITDA is greater than or equal to 1.5. The commitment fee reduces to 0.20% if this ratio is less than 1.5 but greater than or equal to 1.0, and the fee reduces to 0.15% if this ratio is less than 1.0. The revolving credit facility also provides for a commitment guaranty of up to \$5.0 million for letters of credit and requires a per annum fee of 2.50% on outstanding letters of credit. At June 30, 2009, the Company had no letters of credit outstanding. Any outstanding letters of credit decrease the amount available for borrowing under the revolving credit facility.



The credit facility requires a lockbox arrangement, which provide for all receipts to be swept daily to reduce borrowings outstanding under the credit facility. This arrangement, combined with the existence of a Material Adverse Effect (MAE) clause in the credit facility, cause borrowings under the revolving credit facility to be classified as a current liability, per guidance in the FASB's Emerging Issues Task Force Issue 95-22, Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements that Include Both a Subjective Acceleration Clause and a Lock-Box Arrangement. The MAE clause, which is a typical requirement in commercial credit agreements, allows the lender to require the loan to become due if it

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determines there has been a material adverse effect on the Company's operations, business, properties, assets, liabilities, condition or prospects. The classification of borrowings under the revolving credit facility as a current liability is a result only of the combination of the two aforementioned factors: the lockbox arrangement and the MAE clause. The Bank has not notified the Company of any indication of a MAE at June 30, 2009.

At June 30, 2009 the Company had no aggregate indebtedness, including capital lease obligations, short-term debt or long-term debt.

The following table summarizes the Company's contractual obligations at June 30, 2009:

| Contractual Obligations            | Payments due by period |                     |                 |                 |                      |
|------------------------------------|------------------------|---------------------|-----------------|-----------------|----------------------|
|                                    | Total                  | Less than<br>1 year | 1 to 3<br>years | 3 to 5<br>years | More than<br>5 years |
| Long-Term Debt                     |                        |                     |                 |                 |                      |
| Capital Lease Obligations          |                        |                     |                 |                 |                      |
| Operating Leases                   | \$ 680,004             | \$ 201,141          | \$ 381,063      | \$ 97,800       |                      |
| Unconditional Purchase Obligations |                        |                     |                 |                 |                      |
| Other Long-Term Obligations        |                        |                     |                 |                 |                      |
| Total Contractual Cash Obligations | \$ 680,004             | \$ 201,141          | \$ 381,063      | \$ 97,800       | \$                   |

Capital expenditures were \$1.5 million, \$1.1 million and \$0.6 million in fiscal 2009, 2008, and 2007, respectively. The Company believes that cash flows from operations and available borrowings under its credit facilities will be sufficient to finance fixed payments and planned capital expenditures of \$1.2 million in 2010. Cash flows from operations may be negatively impacted by decreases in sales, market conditions, and adverse changes in working capital.

In the event that economic conditions were to severely worsen for a protracted period of time, we believe that we will be able to negotiate an amendment and waiver to our existing credit facility or procure a replacement credit facility, and our projected borrowing capacity under those arrangements will provide sufficient financial flexibility. The Company would have options available to ensure liquidity in addition to increased borrowing. Capital expenditures, which are budgeted at \$1.2 million for the fiscal year ended June 30, 2010, could be postponed. At June 30, 2009, the Company had no bank debt.

Inflation has not had a material effect on the Company's business or results of operations. The Company makes its foreign sales in dollars and, accordingly, sales proceeds are not affected by exchange rate fluctuations, although the effect on its customers does impact the pace of incoming orders.

## Seasonality and Quarterly Results

In past fiscal years, the Company has experienced moderate seasonal increases in net sales during its second and third fiscal quarters (October 1 through March 31) which in turn have affected net income. Such seasonal variations were likely attributable to an increase in hospital equipment purchases at the beginning of each calendar year (which coincides with many hospitals' fiscal years) and an increase in the severity of influenza during winter months.

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The following table sets forth selected operating results for the eight quarters ended June 30, 2009. The information for each of these quarters is unaudited, but includes all normal recurring adjustments which the Company considers necessary for a fair presentation thereof. These operating results, however, are not necessarily indicative of results for any future period. Further, operating results may fluctuate as a result of the timing of orders, the Company's product and customer mix, the introduction of new products by the Company and its competitors, and overall trends in the health care industry and the economy. While these patterns have an impact on the Company's quarterly operations, the Company is unable to predict the extent of this impact in any particular period.

Dollars in thousands, except per share data

| Three months ended,               | June 30,<br>2009 | March 31,<br>2009 | Dec. 31,<br>2008 | Sept. 30,<br>2008 | June 30,<br>2008 | March<br>31,<br>2008 | Dec. 31,<br>2007 | Sept. 30,<br>2007 |
|-----------------------------------|------------------|-------------------|------------------|-------------------|------------------|----------------------|------------------|-------------------|
| Net sales                         | \$12,711         | \$12,390          | \$12,531         | \$14,441          | \$14,692         | \$13,944             | \$13,626         | \$14,102          |
| Gross profit                      | 3,115            | 2,474             | 2,710            | 3,501             | 4,115            | 3,164                | 2,912            | 3,167             |
| Income (loss) from operations     | (16,124)         | (724 )            | (691 )           | 317               | 1,019            | 151                  | (21 )            | 124               |
| Net income (loss)                 | (16,084)         | (450 )            | (436 )           | 208               | 689              | 100                  | 6                | 87                |
| Basic earnings (loss) per share   | (2.04 )          | (0.06 )           | (0.06 )          | 0.03              | 0.09             | 0.01                 |                  | 0.01              |
| Diluted earnings (loss) per share | (2.04 )          | (0.06 )           | (0.06 )          | 0.03              | 0.08             | 0.01                 |                  | 0.01              |

Earnings per share is computed independently for each of the quarters presented. Therefore, the sum of the quarterly amounts will not necessarily equal the total for the year.

## Litigation and Contingencies

The Company becomes, from time to time, a party to personal injury litigation arising out of incidents involving the use of its products. The Company believes that any potential judgments resulting from such claims over its self-insured retention will be covered by the Company's product liability insurance.

## Off Balance Sheet Arrangements

Allied does not have any off balance sheet arrangements.

## Recent Accounting Pronouncements

### New Accounting Pronouncements:

### Recently Adopted Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position ( FSP ) No. FAS 107-1 and Accounting Principles Board Opinion ( APB ) 28-1, Interim Disclosures about Fair Value of Financial Instruments ( FSP FAS 107-1 and APB 28-1 ) which requires public entities to disclose in their interim financial statements the fair

value of all financial instruments within the scope of SFAS No. 107, Disclosures about Fair Value of Financial Instruments, as well as the methods and significant assumptions used to estimate the fair value of those financial instruments. The Company adopted FSP FAS 107-1 and APB 28-1 during the quarter ended June 30, 2009. The adoption of FSP FAS 107-1 and APB 28-1 had no impact on the Company's financial position or results of operations.

Also in April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP 115-2 and 124-2) to change the method for determining whether an other-than-temporary impairment exists for debt securities and the amount of an impairment charge to be recorded in earnings. FSP 115-2 and 124-2 also requires enhanced disclosures, including the Company's methodology and key inputs used for determining the amount of credit losses recorded in earnings. The Company adopted FSP 115-2 and 124-2 during the quarter ended June 30, 2009. The adoption of FSP 115-2 and 124-2 had no impact on the Company's financial position or results of operations.

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In May 2009, the FASB issued SFAS 165. The objective of this statement is to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, this statement sets forth: (a) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; (b) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and (c) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. In accordance with this statement, an entity should apply the requirements to interim or annual financial periods ending after June 15, 2009. The Company adopted SFAS 165 for the year ended June 30, 2009 and the adoption did not have a material impact on its consolidated financial statements.

## **Recently Issued Accounting Pronouncements**

See Item 8, Note 2 Summary of Significant Accounting Policies for a discussion of recent accounting pronouncements and their impact on our consolidated financial statements, if any.

## **Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

At June 30, 2009, the Company did not have any debt outstanding. The revolving credit facility bears an interest rate using the commercial bank's floating reference rate or LIBOR as the basis, as defined in the loan agreement, and therefore is subject to additional expense should there be an increase in market interest rates.

The Company had no holdings of derivative financial or commodity instruments at June 30, 2009. Allied Healthcare Products has international sales; however these sales are denominated in U.S. dollars, mitigating foreign exchange rate fluctuation risk.

## **Item 8. Financial Statements and Supplementary Data**

The following described consolidated financial statements of Allied Healthcare Products, Inc. are included in response to this item:

Report of Independent Registered Public Accounting Firm.  
Consolidated Statement of Operations for the fiscal years ended June 30, 2009, 2008 and 2007.  
Consolidated Balance Sheet for the fiscal years ended June 30, 2009 and 2008.  
Consolidated Statement of Changes in Stockholders' Equity for the fiscal years ended June 30, 2009, 2008 and 2007.  
Consolidated Statement of Cash Flows for the fiscal years ended June 30, 2009, 2008 and 2007.  
Notes to Consolidated Financial Statements.  
Schedule of Valuation and Qualifying Accounts and Reserves for the years ended June 30, 2009, 2008 and 2007.  
All other schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.



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# **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders  
Allied Healthcare Products, Inc.

We have audited the accompanying consolidated balance sheet of Allied Healthcare Products, Inc. and subsidiaries (collectively, the Company) as of June 30, 2009 and 2008, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended June 30, 2009. In connection with our audit of the consolidated financial statements, we also have audited the related financial statement schedule of valuation and qualifying accounts and reserves for the years ended June 30, 2009, 2008 and 2007. These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of 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 consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal controls over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Allied Healthcare Products, Inc. and subsidiaries as of June 30, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2009, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule referred to above, when considered in relation to the consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 5 to the consolidated financial statements, on July 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of Statement of Financial Accounting Standard No. 109*.

/s/ RubinBrown LLP  
St. Louis, Missouri  
September 25, 2009

TABLE OF CONTENTS**ALLIED HEALTHCARE PRODUCTS, INC.****CONSOLIDATED STATEMENT OF OPERATIONS**

| Year ended June 30,  | 2009           | 2008         | 2007         |
|--|----------------|--------------|--------------|
| Net sales  | \$52,072,676   | \$56,364,111 | \$56,500,974 |
| Cost of sales  | 40,273,089     | 43,006,007   | 42,028,125   |
| Gross profit   | 11,799,587     | 13,358,104   | 14,472,849   |
| Selling, general and administrative expenses                   | 13,041,564     | 12,084,971   | 12,051,500   |
| Impairment of goodwill   | 15,979,830     |              |              |
| Income (loss) from operations                                  | (17,221,807 )  | 1,273,133    | 2,421,349    |
| Other (income) expenses:                                       |                |              |              |
| Interest expense   |                | 20,150       |              |
| Interest income  | (60,277 )      | (138,269 )   | (110,790 )   |
| Other, net   | 50,062         | 60,005       | (23,841 )    |
|  | (10,215 )      | (58,114 )    | (134,631 )   |
| Income (loss) before provision for (benefit from) income taxes | (17,211,592 )  | 1,331,247    | 2,555,980    |
| Provision for (benefit from) income taxes                      | (449,779 )     | 448,748      | 914,400      |
| Net income (loss)  | (\$16,761,813) | \$882,499    | \$1,641,580  |
| Basic income (loss) per share:                                 | (\$2.12 )      | \$0.11       | \$0.21       |
| Diluted income (loss) per share:                               | (\$2.12 )      | \$0.11       | \$0.20       |
| Weighted average shares outstanding Basic                      | 7,898,782      | 7,883,659    | 7,875,982    |
| Weighted average shares outstanding Diluted                    | 7,898,782      | 8,119,776    | 8,085,375    |

*See accompanying Notes to Consolidated Financial Statements.*



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|   | June 30,<br>2009 | June 30,<br>2008 |
|---|------------------|------------------|
| <b>ASSETS</b>   |                  |                  |
| Current assets:   |                  |                  |
| Cash and cash equivalents   | \$ 1,943,364     | \$ 6,149,015     |
| Accounts receivable, net of allowances of \$300,000   | 6,172,437        | 6,441,683        |
| Inventories, net  | 12,663,938       | 12,046,450       |
| Income tax receivable   | 937,273          |                  |
| Other current assets  | 327,203          | 394,975          |
| Total current assets  | 22,044,215       | 25,032,123       |
| Property, plant and equipment, net  | 10,799,089       | 10,542,573       |
| Goodwill  |                  | 15,979,830       |
| Other assets, net   | 390,627          | 703,328          |
| Total assets  | \$33,233,931     | \$52,257,854     |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                  |                  |
| Current liabilities:  |                  |                  |
| Accounts payable  | \$ 1,633,568     | \$ 2,590,804     |
| Other accrued liabilities   | 2,316,558        | 2,960,334        |
| Deferred income taxes   | 419,213          | 500,238          |
| Deferred revenue  | 688,200          | 690,000          |
| Total current liabilities   | 5,057,539        | 6,741,376        |
| Deferred revenue  | 1,491,100        | 2,177,500        |
| Commitments and contingencies (Notes 4 and 9)   |                  |                  |
| Stockholders equity:  |                  |                  |
| Preferred stock; \$0.01 par value; 1,500,000 shares authorized; no shares issued and outstanding  |                  |                  |
| Series A preferred stock; \$0.01 par value; 200,000 shares authorized; no shares issued and outstanding   |                  |                  |
| Common stock; \$0.01 par value; 30,000,000 shares authorized; 10,204,819 and 10,188,569 shares issued at June 30, 2009 and June 30, 2008, respectively; 7,901,327 and 7,885,077 shares outstanding at June 30, 2009 and June 30, 2008, respectively | 102,048          | 101,886          |
| Additional paid-in capital  | 47,632,049       | 47,524,084       |
| Retained earnings (deficit)   | (317,377 )       | 16,444,436       |
| Less: treasury stock, at cost; 2,303,492 shares at June 30, 2009 and 2008   | (20,731,428)     | (20,731,428)     |
| Total stockholders equity   | 26,685,292       | 43,338,978       |
| Total liabilities and stockholders equity   | \$33,233,931     | \$52,257,854     |

*See accompanying Notes to Consolidated Financial Statements.*



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# ALLIED HEALTHCARE PRODUCTS, INC.

## CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

|  | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings<br>(Deficit) | Treasury<br>Stock | Total        |
|--|-----------------|----------------------------------|-----------------------------------|-------------------|--------------|
| Balance, July 1, 2006  | \$ 101,556      | \$47,258,182                     | \$ 14,031,500                     | \$(20,731,428)    | \$40,659,810 |
| Issuance of common stock   | 315             | 109,199                          |                                   |                   | 109,514      |
| Stock based compensation   |                 | 73,782                           |                                   |                   | 73,782       |
| Net income for the year<br>ended June 30, 2007   |                 |                                  | 1,641,580                         |                   | 1,641,580    |
| Balance, June 30, 2007   | 101,871         | 47,441,163                       | 15,673,080                        | (20,731,428)      | 42,484,686   |
| Issuance of common stock   | 15              | 6,098                            |                                   |                   | 6,113        |
| Stock based compensation   |                 | 76,823                           |                                   |                   | 76,823       |
| Cumulative effect of<br>adoption of FIN 48,<br>Accounting for Uncertainty<br>in Income Taxes |                 |                                  | (111,143 )                        |                   | (111,143 )   |
| Net income for the year<br>ended June 30, 2008   |                 |                                  | 882,499                           |                   | 882,499      |
| Balance, June 30, 2008   | 101,886         | 47,524,084                       | 16,444,436                        | (20,731,428)      | 43,338,978   |
| Issuance of common stock   | 162             | 80,931                           |                                   |                   | 81,093       |
| Stock based compensation   |                 | 27,034                           |                                   |                   | 27,034       |
| Net loss for the year ended<br>June 30, 2009   |                 |                                  | (16,761,813)                      |                   | (16,761,813) |
| Balance, June 30, 2009   | \$ 102,048      | \$47,632,049                     | \$(317,377 )                      | \$(20,731,428)    | \$26,685,292 |

*See accompanying Notes to Consolidated Financial Statements.*

TABLE OF CONTENTS**ALLIED HEALTHCARE PRODUCTS, INC.****CONSOLIDATED STATEMENT OF CASH FLOWS**

| Year ended June 30,  | 2009           | 2008        | 2007         |
|--|----------------|-------------|--------------|
| Cash flows from operating activities:  |                |             |              |
| Net income (loss)  | \$(16,761,813) | \$882,499   | \$1,641,580  |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |                |             |              |
| Depreciation and amortization  | 1,291,777      | 1,229,753   | 1,230,775    |
| Impairment of goodwill   | 15,979,830     |             |              |
| Stock based compensation   | 27,034         | 76,823      | 73,782       |
| Provision for doubtful accounts and sales returns and allowances                                   | 548            | (212,278 )  | (376 )       |
| Deferred tax provision (benefit)   | 219,432        | (389,052 )  | (53,467 )    |
| Loss (gain) on disposition of equipment  | 8,463          | 42,915      | (307 )       |
| Changes in operating assets and liabilities:   |                |             |              |
| Accounts receivable  | 268,698        | 1,030,061   | 177,964      |
| Inventories  | (617,488 )     | 953,022     | (1,508,167 ) |
| Income tax receivable  | (937,273 )     |             |              |
| Other current assets   | 67,772         | (119,721 )  | (50,401 )    |
| Accounts payable   | (957,236 )     | (449,509 )  | (168,386 )   |
| Deferred revenue   | (688,200 )     | 465,000     | 465,000      |
| Other accrued liabilities  | (643,776 )     | 164,966     | (325,675 )   |
| Net cash provided by (used in) operating activities  | (2,742,232 )   | 3,674,479   | 1,482,322    |
| Cash flows from investing activities:  |                |             |              |
| Capital expenditures   | (1,544,512 )   | (1,135,447) | (649,290 )   |
| Purchase of intangible asset   |                | (35,000 )   |              |
| Net cash used in investing activities  | (1,544,512 )   | (1,170,447) | (649,290 )   |
| Cash flows from financing activities:  |                |             |              |
| Stock options exercised  | 81,093         | 3,438       | 81,090       |
| Excess tax benefit from exercise of stock options  |                | 2,675       | 28,424       |
| Net cash provided by financing activities  | 81,093         | 6,113       | 109,514      |
| Net increase (decrease) in cash and cash equivalents   | (4,205,651 )   | 2,510,145   | 942,546      |
| Cash and cash equivalents at beginning of year   | 6,149,015      | 3,638,870   | 2,696,324    |
| Cash and cash equivalents at end of year   | \$1,943,364    | \$6,149,015 | \$3,638,870  |
| Supplemental disclosures of cash flow information:   |                |             |              |
| Cash paid during the year for:   |                |             |              |
| Interest   | \$             | \$8,934     | \$           |
| Income taxes   | \$658,512      | \$616,382   | \$917,126    |

*See accompanying Notes to Consolidated Financial Statements.*



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# **ALLIED HEALTHCARE PRODUCTS, INC.**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

### **1. Organization**

Allied Healthcare Products, Inc. (the Company or Allied) is a manufacturer of respiratory products used in the health care industry in a wide range of hospital and alternate site settings, including post-acute care facilities, home health care and trauma care. The Company's product lines include respiratory care products, medical gas equipment and emergency medical products.

### **2. Summary of Significant Accounting Policies**

The significant accounting policies followed by Allied are described below.

#### **Use of estimates**

The policies utilized by the Company in the preparation of the consolidated financial statements conform to accounting principles generally accepted in the United States of America, and require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from those estimates.

#### **Principles of consolidation**

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany transactions and intercompany balances are eliminated.

#### **Revenue recognition**

Revenue is recognized for all sales, including sales to agents and distributors, at the time products are shipped and title has transferred, provided that a purchase order has been received or a contract executed, there are not uncertainties regarding customer acceptance, the sales price is fixed and determinable and collectibility is reasonably assured. Sales discounts, returns and allowances are included in net sales, and the provision for doubtful accounts is included in selling, general and administrative expenses. Additionally, it is the Company's practice to include revenues generated from freight billed to customers in net sales with corresponding freight expense included in cost of sales in the consolidated statement of operations.

The sales price is fixed by Allied's acceptance of the buyer's firm purchase order. The sales price is not contingent, or subject to additional discounts. Allied's standard shipment terms are F.O.B. shipping point as stated in Allied's Terms and Conditions of Sale. The customer is responsible for obtaining insurance for and bears the risk of loss for product in-transit. Additionally, sales to customers do not include the right to return merchandise without the prior consent of Allied. In those cases where returns are accepted, product must be current and restocking fees must be paid by the

respective customer. A provision has been made for estimated sales returns and allowances. These estimates are based on historical analysis of credit memo data and returns.

Allied does not provide installation services for its products. Most products shipped are ready for immediate use by the customer. The Company's in-wall medical system components, central station pumps and compressors, and headwalls do require installation by the customer. These products are typically purchased by a third-party contractor who is ultimately responsible for installation services. Accordingly, the customer purchase order or contract does not require customer acceptance of the installation prior to completion of the sale transaction and revenue recognition. Allied's standard payment terms are net 30 days from the date of shipment, and payment is specifically not subject to customer inspection or acceptance, as stated in Allied's Terms and Conditions of Sale. The buyer becomes obligated to pay Allied at the time of shipment. Allied requires credit applications from its customers and performs credit reviews to determine the creditworthiness of new customers. Allied requires letters of credit, where warranted, for international transactions. Allied also protects its legal rights under mechanics lien laws when selling to contractors.

Allied does offer limited warranties on its products. The standard warranty period is one year. The Company's cost of providing warranty service for its products for the years ended June 30, 2009, June 30, 2008, and June 30, 2007 was \$166,651, \$62,954, and \$118,967, respectively. The related liability for warranty service amounted to \$104,157 and \$86,343 at June 30, 2009 and 2008, respectively.

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## **ALLIED HEALTHCARE PRODUCTS, INC.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Cash and cash equivalents**

For purposes of the statement of cash flows, the Company considers all highly liquid investments with a maturity of three months or less when acquired to be cash equivalents.

##### **Foreign currency transactions**

Allied has international sales which are denominated in U.S. dollars, the functional currency for these transactions.

##### **Accounts receivable and concentrations of credit risk**

Accounts receivable are recorded at the invoiced amount. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. The Company maintains reserves for potential credit losses based on past experience and an analysis of current amounts due, and historically such losses have been within management's expectations. The Company's customers can be grouped into three main categories: medical equipment distributors, construction contractors and health care institutions. At June 30, 2009 the Company believes that it has no significant concentration of credit risk.

##### **Inventories**

Inventories are stated at the lower of cost, determined using the last-in, first-out (LIFO) method, or market. If the first-in, first-out method (which approximates replacement cost) had been used in determining cost, inventories would have been \$2,222,825 and \$2,404,262 higher at June 30, 2009 and 2008, respectively. Changes in the LIFO reserve are included in cost of sales. Cost of sales was reduced by \$0, \$10,373 and \$0 in fiscal 2009, 2008, and 2007 respectively, as a result of LIFO liquidations. Costs in inventory include raw materials, direct labor and manufacturing overhead.

Inventory is recorded net of a reserve for obsolete and excess inventory which is determined based on an analysis of inventory items with no usage in the preceding year and for inventory items for which there is greater than two years usage on hand. The reserve for obsolete and excess inventory was \$1,347,648 and \$1,299,483 at June 30, 2009 and 2008, respectively.

##### **Property, plant and equipment**

Property, plant and equipment are recorded at cost and are depreciated using the straight-line method over the estimated useful lives of the assets, which range from 3 to 35 years. Expenditures for repairs, maintenance and



renewals are charged to income as incurred. Expenditures, which improve an asset or extend its estimated useful life, are capitalized. When properties are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts and any gain or loss is included in income.

## Goodwill

At June 30, 2008 the Company had goodwill of \$16.0 million. As a result of impairment testing as of June 30, 2009 the Company wrote down all of its goodwill so that at June 30<sup>th</sup>, 2009 the Company had zero goodwill. This impairment reflected the deteriorating market conditions the Company faces and lower prospects for earnings and cash flow. The amount of the impairment was determined in accordance with Statement of Financial Accounting Standards 142 Goodwill and Other Intangibles, which compares carrying value to the estimated fair value of assets and liabilities. See Note 13 for more information regarding the impairment of goodwill. The Company conducts a formal impairment test of goodwill annually at June 30<sup>th</sup> and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company below its carrying value.

Allied operates as one reporting unit and prepares its annual goodwill impairment test in that manner. None of the Company's product lines constitute a business, as that term is defined in Emerging Issues Task Force (EITF) Issue 98-3. Most of its products are produced in one facility, and Allied does not produce separate financial statements for any part of its business.

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## **ALLIED HEALTHCARE PRODUCTS, INC.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Impairment of long-lived assets**

The Company evaluates impairment of long-lived assets under the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. SFAS No. 144 provides a single accounting model for long-lived assets to be disposed of and reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Under SFAS No. 144, if the sum of the expected future cash flows (undiscounted and without interest charges) of the long-lived assets is less than the carrying amount of such assets, an impairment loss will be recognized. No impairment losses of long-lived assets or identifiable intangibles were recorded by the Company for fiscal years ended June 30, 2009, 2008, and 2007.

##### **Self-insurance**

The Company maintains a self-insurance program for a portion of its health care costs. Self-insurance costs are accrued based upon the aggregate of the liability for reported claims and the estimated liability for claims incurred but not reported. As of June 30, 2009 and 2008, the Company had \$395,000 and \$300,000 respectively, of accrued liabilities related to health care claims. In order to establish the self-insurance reserves, the Company utilized actuarial estimates of expected claims based on analyses of historical data.

##### **Fair value of financial instruments**

The Company's financial instruments consist of cash, accounts receivable and accounts payable. The carrying amounts for cash, accounts receivable and accounts payable approximate their fair value due to the short maturity of these instruments.

##### **Income taxes**

The Company accounts for income taxes under SFAS No. 109, *Accounting for Income Taxes*. Under SFAS No. 109, the deferred tax provision is determined using the liability method, whereby deferred tax assets and liabilities are recognized based upon temporary differences between the financial statement and income tax bases of assets and liabilities using presently enacted tax rates. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

The Company recognizes tax liabilities when, despite the Company's belief that its tax return positions are supportable, the Company believes that certain positions may not be fully sustained upon review by tax authorities. Benefits from tax positions are measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement. To the extent the Company deems it necessary to record a liability for its tax positions, the current portion of the liability is included in income taxes payable and the noncurrent portion is included in other liabilities in

consolidated balance sheet. If upon the final tax outcome of these matters the ultimate liability is different than the amounts recorded, such differences are reflected in income tax expense in the period in which such determination is made. The Company's federal tax returns for the fiscal years after 2007 remain subject to examination. The various states in which the Company is subject to income tax are generally open for the tax fiscal years 2005 and after.

The Company classifies interest expenses on taxes payable as interest expense. Penalties are classified as a component of other expenses.

## **Research and development costs**

Research and development costs are expensed as incurred and are included in selling, general and administrative expenses. Research and development expenses for the years ended June 30, 2009, 2008 and 2007 were \$917,506, \$799,925, and \$844,890, respectively.

TABLE OF CONTENTS**ALLIED HEALTHCARE PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****2. Summary of Significant Accounting Policies (continued)****Earnings per share**

Basic earnings per share are based on the weighted average number of shares of common stock outstanding during the year. Diluted earnings per share are based on the sum of the weighted averaged number of shares of common stock and common stock equivalents outstanding during the year. The weighted average number of basic shares outstanding for the years ended June 30, 2009, 2008 and 2007 was 7,898,782, 7,883,659 and 7,875,982 shares, respectively. The weighted average number of diluted shares outstanding for the years ended June 30, 2009, 2008 and 2007 was 7,898,782, 8,119,776 and 8,085,375 shares, respectively. The dilutive effect of the Company's employee and director stock option plans are determined by use of the treasury stock method.

**Employee stock-based compensation**

On July 1, 2005 the company adopted the provisions of Financial Accounting Standards Board Statement No. 123R, Share-Based Payment (SFAS 123R), using the modified prospective transition method which does not require prior periods to be restated. Statement 123R sets accounting requirements for share-based compensation to employees, including employee stock purchase plans, and requires companies to recognize in the statement of operations the grant-date fair value of the stock options and other equity-based compensation.

The fair value of options granted is estimated on the date of grant using the Black-Scholes option-pricing model. The following table summarizes the weighted average assumptions utilized in the Black-Scholes option pricing model for options granted during the fiscal years ended June 30, 2009, 2008 and 2007.

|   | 2009    | 2008    | 2007    |
|---|---------|---------|---------|
| Weighted-average fair value               | \$ 1.72 | \$ 3.00 | \$ 2.53 |
| Weighted-average volatility               | 40 %    | 40 %    | 41 %    |
| Weighted-average expected life (in years) | 6.0     | 6.0     | 6.2     |
| Weighted-average risk-free interest rate  | 2.75 %  | 3.91 %  | 4.69 %  |
| Dividend yield                            | 0 %     | 0 %     | 0 %     |

Expected volatility is based on the historical volatility of the Company's common stock to estimate future volatility. The risk-free rates are taken from rates as published by the Federal Reserve and represent the yields on actively traded treasury securities for terms equal or approximately equal to the expected terms of the options. The expected term is calculated using the SEC Staff Accounting Bulletin 107 simplified method. The dividend yield is zero based on the fact that the Company has no intention of paying dividends in the near term.

Share-based compensation expense included in the statement of operations for the fiscal years ended June 30, 2009, 2008 and 2007 was approximately \$27,000, \$77,000 and \$74,000 respectively. Unrecognized share-based compensation cost related to unvested stock options for the fiscal year ended June 30, 2009 amounts to approximately

\$36,000. The cost is expected to be recognized over the next three fiscal years.

The following table summarizes stock option exercises for the fiscal years ended June 30, 2009, 2008 and 2007.

|  | 2009      | 2008     | 2007      |
|--|-----------|----------|-----------|
| Stock options exercised                          | 16,250    | 1,500    | 31,500    |
| Total intrinsic value of stock options exercised | \$ 25,281 | \$ 6,688 | \$ 78,210 |
| Cash received from stock option exercises        | \$ 81,100 | \$ 3,438 | \$ 81,090 |
| Tax benefit from stock options exercised         | \$ 10,113 | \$ 2,675 | \$ 28,424 |

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## **ALLIED HEALTHCARE PRODUCTS, INC.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

#### **2. Summary of Significant Accounting Policies (continued)**

Prior to July 1, 2005, the Company accounted for employee stock options in accordance with Accounting Principles Board No. (APB) 25, Accounting for Stock Issued to Employees. Under APB 25, the Company applies the intrinsic value method of accounting. The Company did not recognize compensation expense at the grant date for options granted because the Company grants options at a price equal to the market value at the time of grant.

#### **New accounting standards**

##### **New Accounting Pronouncements:**

#### **Recently Adopted Accounting Pronouncements**

In April 2009, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position ( FSP ) No. FAS 107-1 and Accounting Principles Board Opinion ( APB ) 28-1, Interim Disclosures about Fair Value of Financial Instruments ( FSP FAS 107-1 and APB 28-1 ) which requires public entities to disclose in their interim financial statements the fair value of all financial instruments within the scope of SFAS No. 107, Disclosures about Fair Value of Financial Instruments, as well as the methods and significant assumptions used to estimate the fair value of those financial instruments. The Company adopted FSP FAS 107-1 and APB 28-1 during the quarter ended June 30, 2009. The adoption of FSP FAS 107-1 and APB 28-1 had no impact on the Company's financial position or results of operations.

Also in April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments ( FSP 115-2 and 124-2 ) to change the method for determining whether an other-than-temporary impairment exists for debt securities and the amount of an impairment charge to be recorded in earnings. FSP 115-2 and 124-2 also requires enhanced disclosures, including the Company's methodology and key inputs used for determining the amount of credit losses recorded in earnings. The Company adopted FSP 115-2 and 124-2 during the quarter ended June 30, 2009. The adoption of FSP 115-2 and 124-2 had no impact on the Company's financial position or results of operations.

In May 2009, the FASB issued SFAS 165. The objective of this statement is to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, this statement sets forth: (a) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; (b) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and (c) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. In accordance with this statement, an entity should apply the requirements to interim or annual financial periods ending after June 15, 2009. The Company adopted SFAS 165 for the year ended June 30, 2009 and the adoption did not have a material impact on its consolidated financial statements.

## Recently Issued Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 157, *Fair Value Measurements* ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosure about fair value measurements. This standard does not require any new fair value measurements but provides guidance in determining fair value measurements presently used in the preparation of financial statements. In October 2008, the FASB issued FASB Staff Position ( FSP ) No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* ( FSP No. 157-3 ). FSP No. 157-3 clarifies the application of SFAS No. 157 in an inactive market and illustrates how an entity would determine fair value when the market for a financial asset is not active. For the Company, SFAS No. 157 was originally effective July 1, 2008; however, the effective date of SFAS No. 157 was deferred for nonfinancial assets and liabilities except for items that are recognized or disclosed at fair value in the financial statements on a recurring

basis

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# ALLIED HEALTHCARE PRODUCTS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 2. Summary of Significant Accounting Policies (continued)

for one year pursuant to FSP FAS 157-2 *Effective date of Statement 157*. SFAS 157 will be effective for the Company July 1, 2009. The Company's adoption of SFAS No. 157 is not expected to have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* an amendment of ARB No. 51 ( SFAS 160 ). SFAS 160 amends Accounting Research Bulletin No. 51, *Consolidated Financial Statements* and establishes accounting and reporting standards that require non-controlling interests, previously referred to as minority interests, to be reported as a component of equity. In addition, changes in a parent's ownership interest while the parent retains its controlling interest are accounted for as equity transactions, and upon a gain or loss of control, retained ownership interests are remeasured at fair value, with any gain or loss recognized in earnings. This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company does not expect the adoption of SFAS 160 to have a material impact on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* an amendment of FASB Statement No. 133 ( SFAS 161 ). SFAS 161 applies to all entities and requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk related contingent features in derivative agreements. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company does not expect the adoption of SFAS 161 to have a material impact on its consolidated financial statements

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* ( SFAS 141(R) ) as amended by FASB Staff Position ( FSP ) FAS No. 141(R)-1 ( FSP 141(R)-1 ) issued in April 2009. SFAS 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; how the acquirer recognizes and measures the goodwill acquired in a business combination; and how the acquirer determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. FSP 141(R)-1 addresses certain issues raised upon the issuance of SFAS 141(R), with regard to initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. This Statement shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141(R), as amended, will be effective for any future acquisitions made by the Company.

In April 2008, the FASB finalized FSP FAS No. 142-3, *Determination of the Useful Life of Intangible Assets* ( FSP 142-3 ). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* ( SFAS 142 ). The intent of FSP 142-3 is to improve the consistency between the useful life of a recognized asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS



141(R), and other U.S. generally accepted accounting principles. In addition, FSP 142-3 requires additional disclosures concerning recognized intangible assets. These additional disclosures would enable users of financial statements to assess the extent to which the expected future cash flows associated with the asset are affected by the entity's intent and/or ability to renew or extend the arrangement. FSP 142-3 is effective for fiscal years beginning after December 15, 2008, and interim periods within those years. The Company does not expect the adoption of FSP 142-3 to have a material impact on its consolidated financial statements.

In December 2008, the FASB issued FSP No. 132R-1, *Employers' Disclosures about Postretirement Benefit Plan Assets* ( FSP No. 132R-1 ), which requires companies to disclose information about fair value measurements of retirement plans that would be similar to the disclosures about fair value measurements required by SFAS No. 157. The provisions of FSP No. 132R-1 are effective for fiscal years ending after

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# ALLIED HEALTHCARE PRODUCTS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 2. Summary of Significant Accounting Policies (continued)

December 15, 2009. FSP No. 132R-1 is not expected to have a material impact on the Company's consolidated financial statements, as its requirements impact financial statement disclosures only.

In June 2009, the FASB issued SFAS No. 166, Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140 (SFAS 166). SFAS 166 removes the concept of a qualifying special-purpose entity from SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, establishes a new participating interest definition that must be met for transfers of portions of financial assets to be eligible for sale accounting, clarifies and amends the derecognition criteria for a transfer to be accounted for as a sale, and changes the amount that can be recognized as a gain or loss on a transfer accounted for as a sale when beneficial interests are received by the transferor. Enhanced disclosures are also required to provide information about transfers of financial assets and a transferor's continuing involvement with transferred financial assets. This statement must be applied as of the beginning of an entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company does not expect the adoption of SFAS 166 to have a material impact on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R) (SFAS 167). SFAS 167 amends FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities to require an enterprise to qualitatively assess the determination of the primary beneficiary of a variable interest entity (VIE) based on whether the entity (1) has the power to direct the activities of a VIE that most significantly impact the entity's economic performance and (2) has the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. Also, SFAS 167 requires an ongoing reconsideration of the primary beneficiary, and amends the events that trigger a reassessment of whether an entity is a VIE. Enhanced disclosures are also required to provide information about an enterprise's involvement in a VIE. This statement shall be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company does not expect the adoption of SFAS 167 to have a material impact on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification<sup>TM</sup> and the Hierarchy of Generally Accepted Accounting Principles (SFAS 168). SFAS 168 establishes the FASB Accounting Standards Codification<sup>TM</sup> (the Codification) as the single source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. When effective, the Codification will supersede all existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become non-authoritative. Following SFAS 168, the FASB will not issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, the FASB will issue Accounting Standards Updates, which will serve only to: (a) update the Codification; (b) provide background information about the guidance; and (c) provide the bases for conclusions on the change(s) in the

Codification. SFAS 168 and the Codification are effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company has evaluated this new statement and has determined that it will not have a significant impact on the determination or reporting of its financial results.

### **3. Financing**

The Company has entered into a credit facility arrangement with Bank of America, the successor in interest to LaSalle Bank National Association (the Bank ). The credit facility was amended on September 26, 2002, September 26, 2003, August 25, 2004, September 1, 2005, September 30, 2008.

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## **ALLIED HEALTHCARE PRODUCTS, INC.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

#### **3. Financing (continued)**

Under the terms of the credit facility, the Company is required to be in compliance with certain financial covenants pertaining to stockholders' equity, capital expenditures and net income. Additionally, the terms of the credit facility restrict the Company from the payment of dividends on any class of its stock. At June 30, 2009, the Company was in violation of its fixed charge coverage ratio covenant on the credit agreement. The Company has no outstanding amounts under the credit facility. Based on its discussions with the Bank and other financial institutions, the Company believes it will be able to negotiate an acceptable waiver and amendment with the Bank or to procure a replacement credit facility with another lender. Even if this were not possible, the Company does not anticipate the technical default under the credit facility to materially impact its liquidity.

The revolving credit facility provides for a borrowing base of 80% of eligible accounts receivable plus the lesser of 50% of eligible inventory or \$7.0 million, subject to reserves as established by the Bank. The maximum borrowing under the revolving credit facility is \$10 million. At June 30, 2009, \$10 million was available under the revolving credit facility. However, as of September 25, 2009, the Company does not have any availability under the revolving credit facility due to the financial covenant violations discussed above. As a result of an amendment made on September 30, 2008, the credit facility matures on September 1, 2010. Borrowings under the facility accrue interest at a variable rate equal to the Bank's prime rate. The credit facility calls for a commitment fee payable quarterly based on the average daily unused portion of the revolving credit facility. This commitment fee is 0.25% if the Company's ratio of funded debt to EBITDA is greater than or equal to 1.5. The commitment fee reduces to 0.20% if this ratio is less than 1.5 but greater than or equal to 1.0, and the fee reduces to 0.15% if this ratio is less than 1.0. The revolving credit facility also provides for a commitment guaranty of up to \$5.0 million for letters of credit and requires a per annum fee of 2.50% on outstanding letters of credit. At June 30, 2009, the Company had no letters of credit outstanding. Any outstanding letters of credit decrease the amount available for borrowing under the revolving credit facility.

The credit facility requires lockbox arrangement, which provide for all receipts to be swept daily to reduce borrowings outstanding under the credit facility. This arrangement, combined with the existence of a Material Adverse Effect (MAE) clause in the credit facility, cause borrowings under the revolving credit facility to be classified as a current liability, per guidance in the FASB's Emerging Issues Task Force Issue 95-22, Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements that Include Both a Subjective Acceleration Clause and a Lock-Box Arrangement. The MAE clause, which is a typical requirement in commercial credit agreements, allows the lender to require the loan to become due if it determines there has been a material adverse effect on the Company's operations, business, properties, assets, liabilities, condition or prospects. The classification of the revolving credit facility as a current liability is a result only of the combination of the two aforementioned factors: the lockbox arrangement and the MAE clause. The Bank has not notified the Company of any indication of a MAE at June 30, 2009.

At June 30, 2009 the Company had no aggregate indebtedness, including capital lease obligations, short-term debt and long-term debt.



TABLE OF CONTENTS**ALLIED HEALTHCARE PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****4. Lease Commitments**

The Company leases certain of its equipment under non-cancelable operating lease agreements. Minimum lease payments under operating leases at June 30, 2009 are as follows:

| Fiscal Year                  | Operating<br>Leases |
|------------------------------|---------------------|
| 2010                         | \$ 201,141          |
| 2011                         | 164,545             |
| 2012                         | 118,718             |
| 2013                         | 97,800              |
| 2014                         | 97,800              |
| Total minimum lease payments | \$ 680,004          |

Rental expense incurred on operating leases in fiscal 2009, 2008, and 2007 totaled \$355,975, \$303,158 and \$295,446 respectively.

**5. Income Taxes**

The provision for (benefit from) income taxes consists of the following:

|                | 2009          | 2008       | 2007       |
|----------------|---------------|------------|------------|
| Current:       |               |            |            |
| Federal        | \$ (586,836 ) | \$ 720,838 | \$ 794,900 |
| State          | (101,076 )    | 116,962    | 172,967    |
| Total current  | (687,912 )    | 837,800    | 967,867    |
| Deferred:      |               |            |            |
| Federal        | 203,778       | (299,045 ) | (45,016 )  |
| State          | 34,355        | (90,007 )  | (8,451 )   |
| Total deferred | 238,133       | (389,052 ) | (53,467 )  |
|                | \$ (449,779 ) | \$ 448,748 | \$ 914,400 |

A reconciliation of income taxes, with the amounts computed at the statutory federal rate is as follows:

|  | 2009           | 2008       | 2007       |
|--|----------------|------------|------------|
| Computed tax at federal statutory rate         | (\$5,851,941 ) | \$ 452,624 | \$ 869,033 |
| State income taxes, net of federal tax benefit | (45,887 )      | 17,791     | 108,581    |
| Non deductible goodwill impairment             | 5,433,142      |            |            |
| Other, net                                     | 14,907         | (21,667 )  | (63,214 )  |

|    |       |              |            |            |
|----|-------|--------------|------------|------------|
| 40 | Total | (\$449,779 ) | \$ 448,748 | \$ 914,400 |
|----|-------|--------------|------------|------------|

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TABLE OF CONTENTS**ALLIED HEALTHCARE PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****5. Income Taxes (continued)**

The deferred tax assets and deferred tax liabilities recorded on the balance sheet as of June 30, 2009 and 2008 are as follows:

|                           | 2009                   |                                | 2008                   |                                |
|---------------------------|------------------------|--------------------------------|------------------------|--------------------------------|
|                           | Deferred<br>Tax Assets | Deferred<br>Tax<br>Liabilities | Deferred<br>Tax Assets | Deferred<br>Tax<br>Liabilities |
| Current:                  |                        |                                |                        |                                |
| Bad debts                 | \$ 40,000              | \$                             | \$ 40,000              | \$                             |
| Prepaid expenses          |                        | 30,870                         |                        | 47,310                         |
| Deferred revenue          | 275,280                |                                | 276,000                |                                |
| Accrued liabilities       | 423,496                |                                | 380,599                |                                |
| Inventory                 |                        | 1,127,119                      |                        | 1,149,528                      |
|                           | 738,776                | 1,157,989                      | 696,599                | 1,196,838                      |
| Non Current:              |                        |                                |                        |                                |
| Depreciation              |                        | 412,008                        |                        | 425,332                        |
| Other property basis      |                        |                                |                        | 13,758                         |
| Intangible assets         | 4,309                  |                                | 16,383                 |                                |
| Deferred revenue          | 596,440                |                                | 871,000                |                                |
| Accrued pension liability | 55,812                 |                                | 95,308                 |                                |
| Stock options             | 68,997                 |                                | 79,363                 |                                |
| Other                     | 12,122                 |                                | 3,164                  |                                |
|                           | 737,680                | 412,008                        | 1,065,218              | 439,090                        |
| Valuation Allowance       |                        |                                |                        |                                |
| Total deferred taxes      | \$ 1,476,456           | \$ 1,569,997                   | \$ 1,761,817           | \$ 1,635,928                   |

The net long term deferred tax asset of \$325,672 and \$626,128 is included in other assets in the June 30, 2009 and 2008 consolidated balance sheet, respectively. At June 30, 2009 there were \$1.7 million dollars of net operating loss carryforwards which would expire in 2029, however, this net operating loss will be carried back to offset taxes previously paid for prior years.

In 2006, the FASB issued FIN 48, which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that the Company recognize in its financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The Company adopted the provisions of FIN 48 on July 1, 2007, the beginning of the Company's fiscal year. Upon the adoption of FIN 48 on July 1, 2007, the Company recognized a \$286,549 increase in the liability for unrecognized tax benefits including interest and penalties.

The increase was accounted for as a reduction to the July 1, 2007 balance of retained earnings in the amount of \$111,143 and an increase to deferred tax assets of \$175,406. The total liability for unrecognized tax benefits totaled \$286,549 as of July 1, 2007.



Changes in the unrecognized tax benefit during fiscal year 2008 were as follows:

|  | Unrecognized<br>Tax Benefit |
|--|-----------------------------|
| Beginning balance July 1, 2007         | \$ 286,549                  |
| Tax positions related to prior years:  |                             |
| Additions                              | 120,708                     |
| Settlements                            | (407,257 )                  |
| Tax positions related to current year: |                             |
| Additions                              | 0                           |
| Reductions                             | 0                           |
| Lapses in statue of limitations        | 0                           |
| Ending balance June 30, 2008           | \$ 0                        |

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## **ALLIED HEALTHCARE PRODUCTS, INC.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

#### **5. Income Taxes (continued)**

The addition of \$120,708 and settlement of \$407,257 for prior year tax positions relate to the IRS examination for fiscal years 2005 and 2006. The examination was settled in fiscal 2008 and the Company paid additional federal taxes of \$266,472 and interest of \$53,132. Amended state income tax returns for fiscal 2005 and 2006 were filed to report the IRS adjustments. State taxes and interest expense related to the amended returns are estimated to be \$64,334, and are included in current liabilities at June 30, 2008. IRS adjustments resulted in an additional liability for unrecognized tax benefits of \$120,708, and an increase to deferred tax assets of \$133,878.

The Company recognizes interest on taxes payable as interest expense and penalties accrued related to unrecognized tax benefits as a component of other expenses. Interest expense recognized for the period ended June 30, 2008 was \$34,023. No penalties were incurred in the settlement of the IRS examination. As a result accrued penalties in the amount of \$34,035 were eliminated during the period ended June 30, 2008.

The Company files a federal and multiple state income tax returns. The Company's federal income tax returns are open for fiscal years ending after June 30, 2007. State income tax returns are open for years ending after June 30, 2005.

Management of the Company is not aware of any additional needed liability for unrecognized tax benefits at June 30, 2009 and June 30, 2008.

#### **6. Retirement Plan**

The Company offers a retirement savings plan under Section 401(k) of the Internal Revenue Code to certain eligible salaried employees. Each employee may elect to enter a written salary deferral agreement under which a portion of such employee's pre-tax earnings may be contributed to the plan.

During the fiscal years ended June 30, 2009, 2008 and 2007, the Company made contributions of \$272,931, \$257,309, and \$255,377, respectively.

#### **7. Stockholders Equity**

The Company has established a 1994 Employee Stock Option Plan and a 1999 Incentive Stock Plan (collectively the Employee Plans). The Employee Plans provide for the granting of options to the Company's executive officers and key employees to purchase shares of common stock at prices equal to the fair market value of the stock on the date of grant. Options to purchase up to 1,550,000 shares of common stock may be granted under the Employee Plans. Options generally become exercisable ratably over a four year period or one-fourth of the shares covered thereby on each anniversary of the date of grant, commencing on the first or second anniversary of the date granted. The right to exercise the options expires in ten years from the date of grant, or earlier if an option holder ceases to be employed by the Company.

In addition, the Company has established a 1995 Directors Non-Qualified Stock Option Plan and a 2005 Directors Non-Qualified Stock Option Plan (collectively the Directors Plans ). The Directors Plans provide for the granting of options to the Company s directors who are not employees of the Company to purchase shares of common stock at prices equal to the fair market value of the stock on the date of grant. Options to purchase up to 225,000 shares of common stock may be granted under the Directors Plans. Options shall become exercisable with respect to one-fourth of the shares covered thereby on each anniversary of the date of grant, commencing on the second anniversary of the date granted, except for certain options which become exercisable with respect to all of the shares covered thereby one year after the grant date. The right to exercise the options expires in ten years from the date of grant, or earlier if an option holder ceases to be a director of the Company.

TABLE OF CONTENTS**ALLIED HEALTHCARE PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****7. Stockholders Equity (continued)**

A summary of stock option transactions in fiscal 2007, 2008 and 2009, respectively, pursuant to the Employee Plans and the Directors Plans is as follows:

|                              | Shares    | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (years) | Aggregate<br>Intrinsic<br>Value |
|------------------------------|-----------|--|---|---------------------------------|
| June 30, 2006                | 741,750   | \$ 2.66                                  |   |                                 |
| Options Granted              | 51,500    | \$ 5.26                                  |   |                                 |
| Options Exercised            | (31,500 ) | \$ 2.57                                  |   |                                 |
| Options Forfeited or Expired | (29,000 ) | \$ 5.77                                  |   |                                 |
| June 30, 2007                | 732,750   | \$ 2.72                                  | 3.2   | \$ 2,886,479                    |
| June 30, 2007                | 732,750   | \$ 2.72                                  |   |                                 |
| Options Granted              | 6,000     | \$ 6.73                                  |   |                                 |
| Options Exercised            | (1,500 )  | \$ 2.29                                  |   |                                 |
| Options Forfeited or Expired | (21,500 ) | \$ 7.35                                  |   |                                 |
| June 30, 2008                | 715,750   | \$ 2.62                                  | 2.3   | \$ 3,172,070                    |
| June 30, 2008                | 715,750   | \$ 2.62                                  |   |                                 |
| Options Granted              | 6,000     | \$ 4.05                                  |   |                                 |
| Options Exercised            | (16,250 ) | \$ 4.99                                  |   |                                 |
| Options Forfeited or Expired | (15,000 ) | \$ 5.25                                  |   |                                 |
| June 30, 2009                | 690,500   | \$ 2.52                                  | 1.2   | \$ 1,312,131                    |
| Exercisable at June 30, 2009 | 660,750   | \$ 2.41                                  | 0.9   | \$ 1,310,631                    |

The following table provides additional information for options outstanding and exercisable at June 30, 2009:

**Options Outstanding**

| Range of Exercise Prices | Number  | Weighted<br>Average<br>Remaining<br>Life | Weighted<br>Average<br>Exercise<br>Price |
|--------------------------|---------|--|--|
| 2.00                     | 542,000 | 0.2 years                                | \$ 2.00                                  |
| 2.01 4.00                | 67,500  | 2.1 years                                | \$ 3.35                                  |
| 4.01 6.99                | 81,000  | 7.0 years                                | \$ 5.29                                  |
| \$2.00 6.99              | 690,500 | 1.2 years                                | \$ 2.52                                  |

## Options Exercisable

| Range of Exercise Prices | Number  | Weighted<br>Average<br>Exercise<br>Price |
|--------------------------|---------|--|
| 2.00                     | 542,000 | \$ 2.00                                  |
| 2.01 4.00                | 67,500  | \$ 3.35                                  |
| 4.01 6.99                | 51,250  | \$ 5.47                                  |
| \$2.00 6.99              | 660,750 | \$ 2.41                                  |

See Note 2 for discussion of accounting for stock awards and related fair value disclosures.

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|  |                                     | June 30,<br>2009 | 2008          |
|--|-------------------------------------|------------------|---------------|
| Inventories                                    |                                     |                  |               |
| Work in progress                               |                                     | \$ 718,711       | \$ 807,358    |
| Component parts                                |                                     | 8,981,435        | 8,072,976     |
| Finished goods                                 |                                     | 4,311,440        | 4,465,599     |
| Reserve for obsolete and excess inventory      |                                     | (1,347,648 )     | (1,299,483 )  |
|  |                                     | \$ 12,663,938    | \$ 12,046,450 |
|  |                                     |                  |               |
|  | Estimated<br>Useful Life<br>(years) |                  |               |
| Property, plant and equipment                  |                                     |                  |               |
| Machinery and equipment                        | 3 10                                | \$ 11,128,838    | \$ 9,697,215  |
| Buildings                                      | 28 35                               | 12,203,870       | 12,203,870    |
| Land and land improvements                     | 5 7                                 | 934,216          | 934,216       |
| Total property, plant and equipment at cost    |                                     | 24,266,924       | 22,835,301    |
| Less accumulated depreciation and amortization |                                     | (13,467,835)     | (12,292,728)  |
|  |                                     | \$ 10,799,089    | \$ 10,542,573 |
| Other accrued liabilities                      |                                     |                  |               |
| Accrued compensation expense                   |                                     | \$ 1,682,680     | \$ 1,589,637  |
| Accrued income tax                             |                                     |                  | 374,741       |
| Customer deposits                              |                                     | 278,549          | 676,178       |
| Other  |                                     | 355,329          | 319,778       |
|  |                                     | \$ 2,316,558     | \$ 2,960,334  |

**9. Commitments and Contingencies****Legal Claims**

The Company is subject to various investigations, claims and legal proceedings covering a wide range of matters that arise in the ordinary course of its business activities. The Company intends to continue to conduct business in such a manner as to avert any FDA action seeking to interrupt or suspend manufacturing or require any recall or modification of products.

The Company has recognized the costs and associated liabilities only for those investigations, claims and legal proceedings for which, in its view, it is probable that liabilities have been incurred and the related amounts are

estimable. Based upon information currently available, management believes that existing accrued liabilities are sufficient and that it is not reasonably possible at this time that any additional liabilities will result from the resolution of these matters that would have a material adverse effect on the Company's consolidated results of operations, financial position, or cash flows.

## **Employment Contract**

In March 2007, the Company entered into an employment contract with its chief executive officer. The contract is initially for a three-year term, after which point it is subject to annual renewals. The contract includes termination without cause and change of control provisions, under which the employee is entitled to receive specified severance payments generally equal to two times ending annual salary if terminated without cause or within thirty days after a change in control.

TABLE OF CONTENTS**ALLIED HEALTHCARE PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****10. Segment Information**

The Company operates in one segment consisting of the manufacturing, marketing and distribution of a variety of respiratory products used in the health care industry to hospitals, hospital equipment dealers, hospital construction contractors, home health care dealers and emergency medical product dealers. The Company's product lines include respiratory care products, medical gas equipment and emergency medical products. The Company does not have any one single customer that represents more than 10 percent of total sales. Sales by region, and by product, are as follows:

## Sales by Region

|                        | 2009          | 2008          | 2007          |
|------------------------|---------------|---------------|---------------|
| Domestic United States | \$ 41,932,370 | \$ 45,592,686 | \$ 46,265,621 |
| Europe                 | 1,272,728     | 1,390,788     | 1,404,099     |
| Canada                 | 1,136,094     | 1,144,070     | 1,271,561     |
| Latin America          | 4,426,046     | 4,923,096     | 4,420,697     |
| Middle East            | 1,207,774     | 397,871       | 1,016,756     |
| Far East               | 1,941,170     | 2,491,820     | 2,011,521     |
| Other International    | 156,494       | 423,780       | 110,719       |
|                        | \$ 52,072,676 | \$ 56,364,111 | \$ 56,500,974 |

## Sales by Product

|                            | 2009          | 2008          | 2007          |
|----------------------------|---------------|---------------|---------------|
| Respiratory care products  | \$ 12,303,067 | \$ 14,248,031 | \$ 13,899,027 |
| Medical gas equipment      | 29,655,930    | 30,744,058    | 32,774,962    |
| Emergency medical products | 10,113,679    | 11,372,022    | 9,826,985     |
|                            | \$ 52,072,676 | \$ 56,364,111 | \$ 56,500,974 |

**11. Quarterly Financial Data (unaudited)**

Summarized quarterly financial data for fiscal 2009 and 2008 appears below (all amounts in thousands):

Earnings per share is computed independently for each of the quarters presented. Therefore, the sum of the quarterly amounts will not necessarily equal the total for the year.



## 12. Baralyme® Agreement

On August 27, 2004, Allied entered into an agreement with Abbott Laboratories ( Abbott ) pursuant to which Allied agreed to cease production of its product Baralyme®, and to affect the withdrawal of Baralyme® product held by distributors. The agreement permits Allied to pursue the development of a new carbon dioxide absorbent product. Baralyme®, a carbon dioxide absorbent product, has been used safely and effectively in connection with inhalation anesthetics since its introduction in the 1920s. In recent years, the number of inhalation anesthetics has increased, giving rise to concerns regarding the use of Baralyme® in conjunction

TABLE OF CONTENTS**ALLIED HEALTHCARE PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****12. Baralyme® Agreement (continued)**

with these newer inhalation anesthetics if Baralyme® has been allowed, contrary to recommended practice, to become desiccated. The agreement also provides that, for a period of eight years, Allied will not manufacture, distribute, promote, market, sell, commercialize or donate any Baralyme® product or similar product based upon potassium hydroxide and will not develop or license any new carbon dioxide absorbent product containing potassium hydroxide.

In consideration of the foregoing, Abbott agreed to pay Allied an aggregate of \$5,250,000 of which \$1,530,000 was paid on September 30, 2004 and the remainder payable in four equal annual installments of \$930,000 due on July 1, 2005 through July 1, 2008. The installment due on July 1, 2008 was received by Allied on June 19, 2008.

The initial payment of \$1,530,000 from Abbott was received on September 30, 2004. The agreement required Abbott to pay Allied \$600,000 for reimbursement of Allied's cost incurred in connection with withdrawal of Baralyme® from the market, the disposal of such product, and severance payments payable as a result of such withdrawal. This payment by Abbott of \$600,000 has been included in net sales during the year ended June 30, 2005, in accordance with the FASB's EITF Issue No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent. The Company is the primary obligor in the arrangement. It has sole authority to determine the method of withdrawal of Baralyme® and discretion in such matters as employee layoffs, disposal methods, and customer communications regarding the sale of replacement products. The costs of executing the withdrawal are the sole responsibility of the Company.

The payments received from Abbott are being recognized into income, as net sales, over the eight-year term of the agreement. Allied has no further obligations under this agreement which would require the Company to repay these amounts or otherwise impact this accounting treatment. During the year ended June 30, 2009, \$688,200 was recognized into income as net sales.

A reconciliation of deferred revenue resulting from the agreement with Abbott, with the amounts received under the agreement, and amounts recognized as net sales is as follows:

|   | Twelve Months<br>ended June 30, |             |
|---|---------------------------------|-------------|
|   | 2009                            | 2008        |
| Beginning balance                         | \$2,867,500                     | \$2,402,500 |
| Payment Received from Abbott Laboratories |                                 | 930,000     |
| Revenue recognized as net sales           | (688,200 )                      | (465,000 )  |
|   | 2,179,300                       | 2,867,500   |
| Less Current portion of deferred revenue  | (688,200 )                      | (690,000 )  |
|   | \$1,491,100                     | \$2,177,500 |

In addition to the provisions of the agreement relating to the withdrawal of the Baralyme® product, Abbott has agreed to pay Allied up to \$2,150,000 in product development costs to pursue development of a new carbon dioxide absorption product for use in connection with inhalation anesthetics that does not contain potassium hydroxide and

does not produce a significant exothermic reaction with currently available inhalation agents. As of June 30, 2009, \$2,150,000 has been received as a result of product development activities.

In 2004, Allied's sales of Baralyme® were approximately \$2.0 million and contributed approximately \$0.6 million in pre-tax earnings and cash flow from operations. The majority of the \$5,250,000 Allied has received from Abbott will be recognized into income over the eight-year term of the agreement. The net cash flow realized by Allied under the agreement with Abbott is substantially equivalent to the net cash flow Allied would have expected to realize from continued manufacture and sales of Baralyme® during the initial five years of the period.

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## **ALLIED HEALTHCARE PRODUCTS, INC.**

# **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

### **13. Goodwill**

Goodwill initially arises from business acquisitions and represents the value of unidentifiable intangibles in an acquired business. Goodwill is then evaluated at least annually for impairment in accordance with SFAS No. 142 Goodwill and Other Intangible Assets.

At June 30, 2008 the Company had goodwill of \$16.0 million. As a result of impairment testing as of June 30, 2009 the Company wrote down all of its goodwill so that at June 30<sup>th</sup>, 2009 the Company had zero goodwill. This impairment reflected the deteriorating market conditions the Company faces and lower prospects for earnings and cash flow. The amount of the impairment was determined in accordance with SFAS 142 Goodwill and Other Intangibles, which compares carrying value to the estimated fair value of assets and liabilities. The Company conducts a formal impairment test of goodwill annually at June 30<sup>th</sup> and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company below its carrying value. The annual impairment test did not indicate an impairment of goodwill at June 30, 2008, or 2007.

Allied operates as one reporting unit and prepares its annual goodwill impairment test in that manner. None of the Company's product lines constitute a business, as that term is defined in Emerging Issues Task Force (EITF) Issue 98-3. Most of its products are produced in one facility, and Allied does not produce separate financial statements for any part of its business.

At June 30, 2008 the Company had goodwill of \$16.0 million, resulting from the excess of the purchase price over the fair value of net assets acquired in business combinations. The Company completed its annual goodwill impairment test during the fourth quarter of the fiscal year ended June 30, 2009. Due to a general slow down in orders as a result of the current recession, operating profits and cash flows were lower than expected during fiscal 2009. Based on that trend, management revised its earnings forecast for fiscal 2009. In addition, during 2009 the stock traded below book value, in part due to the global economic downturn's impact on Company performance and the turmoil in the equity markets.

In accordance with SFAS 142, a two step process is used to test for goodwill impairment. The first step is to determine if there is an indication of impairment by comparing the estimated fair value of the Company to its carrying value including existing goodwill. Goodwill is considered impaired if the carrying value of the Company exceeds the estimated fair value. Upon indication of impairment, a second step is performed to determine the amount of the impairment by comparing the implied fair value of the Company's goodwill with its carrying value.

To estimate the fair value of the Company for step one, the Company utilized a combination of income and market approaches. The income approach, specifically a discounted cash flow methodology, included assumptions for, among others, forecasted revenues, gross profit margins, operating profit margins, working capital cash flow, perpetual growth rates and long term discount rates, all of which requires significant judgments by management. These assumptions take into account the current recessionary environment and its impact on the Company's business. In addition, the Company utilized a discount rate appropriate to compensate for its earning risk relative the equity markets as a whole. The Company considered historical industry transactions in arriving at an appropriate control

premium to identify the value of the company to market participants for the market approach.

The results of step one indicated that the Company's goodwill was substantially impaired. A step two analysis was performed to the extent necessary to determine that all of the Company's goodwill was impaired. Accordingly, the Company wrote off the entire goodwill balance and recorded an impairment charge of \$16.0 million. As a result, at June 30, 2009 the Company had a goodwill balance of zero. The goodwill impairment charge is non-cash in nature and does not affect the company's liquidity, cash flows from operating activities or debt covenants and will not have a material impact on future operations.

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## ALLIED HEALTHCARE PRODUCTS, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 13. Goodwill (continued)

In accordance with SFAS 144, *Accounting for Impairment or Disposal of Long-Lived Assets*, the Company also evaluated the recoverability of its long-lived assets. Based upon this evaluation, the Company determined that there was no impairment of these assets.

#### 14. Subsequent Events

The Company has performed a review of events subsequent to the balance sheet date through September 25, 2009, the date the financial statements were issued.

Under the terms of the credit facility, the Company is required to be in compliance with certain financial covenants pertaining to stockholders' equity, capital expenditures and net income. Additionally, the terms of the credit facility restrict the Company from the payment of dividends on any class of its stock. At June 30, 2009, the Company was in violation of its fixed charge coverage ratio covenant.

On August 19, 2009 the Compensation Committee of the Board of Directors approved an amendment to the 1999 Incentive Stock Option Plan to permit the cashless exercise of certain stock options outstanding under the plan.

On August 20, 2009 an option holder exercised 542,000 options at a strike price of \$2.00 per share utilizing a cashless exercise. After withholding for the minimum statutory tax requirements and the exercise price of the options the option holder received 190,559 shares of the Company's stock.

On August 27, 2009 the Board of Directors approved a 2009 Incentive Stock Option Plan. The 2009 Plan provides for the issuance of up to 600,000 shares of the Company's common stock as non-qualified stock options, incentive stock options, restricted stock, restricted stock units, stock appreciation rights or other stock-based awards. Power to administer the 2009 Plan was delegated to the Compensation Committee of the Board of Directors. The Plan is subject to approval by the stockholders of the Company.

On August 27, 2009 the Compensation Committee approved an award of options for the purchase of 320,000 shares of the Company's common stock. The options are fully vested and have a strike price of \$4.25, the closing price of the Company's stock on the date immediately prior to the grant date. The options expire on August 27, 2015. The grant agreement remains subject to the approval of the 2009 Incentive Stock Option Plan by the stockholders of the Company.

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**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A(T). Controls and Procedures**

(a) Management's annual report on internal control over financial reporting.

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported within the time period specified in the rules and forms of the SEC, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In connection with our Annual Report on Form 10-K for the fiscal year ended June 30, 2009, as required under Rule 13a-15(b) of the Exchange Act, our management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the date of such evaluation to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms.

(b) Internal control over financial reporting

Our management which is responsible for establishing and maintaining adequate internal control over financial reporting, as a process designed by, or under supervision of, our principal executive and principle financial officer and effected by our Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. and includes those policies and procedures that:

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements.

Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. However these inherent limitations are known features of the financial reporting process. It is possible to design into the process safeguards to reduce, though not eliminate, the risk that misstatements are not prevented or detected on a timely basis.

Management assessed the effectiveness of our internal control over financial reporting as of June 30, 2009. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on this assessment, our management concluded that, as of June 30, 2009, our internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation and presentation of financial statements for external purposes in accordance with generally accepted accounting principles.

This Annual Report on Form 10-K does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the SEC that permit us to provide only management's report in

this Annual Report on Form 10-K.

## **Item 9B. *Other Information***

None.

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## **PART III**

### **Item 10. *Directors, Executive Officers and Corporate Governance***

A list of our executive officers and biographical information appears at the end of Item 1, in Part I of this report. A definitive proxy statement is expected to be filed with the Securities and Exchange Commission on or about October 9, 2009. The information required by this item is set forth under the caption Election of Directors , under the caption Executive Officers , and under the caption Section 16(a) Beneficial Ownership Reporting Compliance in the definitive proxy statement, which information is incorporated herein by reference thereto.

### **Item 11. *Executive Compensation***

The information required by this item is set forth under the caption Executive Compensation in the definitive proxy statement, which information is incorporated herein by reference thereto.

### **Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The information required by this item is set forth under the caption Security Ownership of Certain Beneficial Owners and Management in the definitive proxy statement, which information is incorporated herein by reference thereto.

### **Item 13. *Certain Relationships and Related Transactions, and Director Independence***

None

### **Item 14. *Principal Accounting Fees and Services***

The information by this item will appear in the section entitled Audit Fees included in the Company's definitive Proxy Statement to be filed on or about October 9, 2009, relating to the 2009 Annual Meeting of Shareowners and such information is incorporated herein by reference.

## **PART IV**

### **Item 15. *Exhibits and Financial Statement Schedules***

#### **1. Financial Statements**

The following consolidated financial statements of the Company and its subsidiaries are included in response to Item 8:

Consolidated Statement of Operations for the years ended June 30, 2009, 2008, and 2007  
Consolidated Balance Sheet at June 30, 2009 and 2008  
Consolidated Statement of Changes in Stockholders' Equity for the years ended June 30, 2009, 2008 and 2007  
Consolidated Statement of Cash Flows for the years ended June 30, 2009, 2008 and 2007  
Notes to Consolidated Financial Statements  
Report of Independent Registered Public Accounting Firm

## **2. Financial Statement Schedule**

Valuation and Qualifying Accounts and Reserves for the Years Ended June 30, 2009, 2008 and 2007

All other schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

## **3. Exhibits**

The exhibits listed on the accompanying Index to Exhibits are filed as part of this Report.

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

**ALLIED HEALTHCARE PRODUCTS, INC.**

By:

/s/ Earl R. Refsland  
Earl R. Refsland  
President and Chief Executive Officer

/s/ Daniel C. Dunn  
Daniel C. Dunn  
Vice President, Chief Financial Officer, and  
Secretary

Dated: September 25, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on September 25th, 2009.

| Signatures       | Title  |
|------------------|--|
| *                |  |
| John D. Weil     | Chairman of the Board  |
| *                |  |
| Earl R. Refsland | President, Chief Executive Officer and Director<br>(principal Executive Officer) |
| *                |  |
| William A. Peck  | Director   |
| *                |  |
| Joseph Root      | Director   |
| *                |  |
| Judy Graves      | Director   |
| *By:             |  |

/s/ Earl R. Refsland

Earl R. Refsland  
Attorney-in-Fact

\* Such signature has been affixed pursuant to the following Power of Attorney.

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ACCOUNTS AND RESERVES**

| COLUMN A   | COLUMN B                       | COLUMN C                      | COLUMN D                           | COLUMN E                  |                          |
|--|--------------------------------|-------------------------------|------------------------------------|---------------------------|--------------------------|
| Description  | Balance at Beginning of period | Charged to costs and expenses | Charged to other accounts describe | Deductions describe       | Balance at end of period |
| For the Year Ended June 30, 2009                                 |                                |                               |                                    |                           |                          |
| Accounts Receivable Allowances                                   | (\$300,000 )                   | (\$548 )                      |                                    | \$ 548 (1)                | (\$300,000 )             |
| Inventory Allowance For<br>Obsolescence And Excess<br>Quantities | (\$1,299,483)                  | (\$145,701)                   | (\$50,553 ) <sup>(3)</sup>         | \$ 148,089 (2)            | (\$1,347,648)            |
| For the Year Ended June 30, 2008                                 |                                |                               |                                    |                           |                          |
| Accounts Receivable Allowances                                   | (\$460,000 )                   | \$212,278                     |                                    | (\$52,278) <sup>(1)</sup> | (\$300,000 )             |
| Inventory Allowance For<br>Obsolescence And Excess<br>Quantities | (\$1,099,864)                  | (\$110,000)                   | (\$169,491) <sup>(3)</sup>         | \$ 79,872 (2)             | (\$1,299,483)            |
| For the Year Ended June 30, 2007                                 |                                |                               |                                    |                           |                          |
| Accounts Receivable Allowances                                   | (\$430,000 )                   | \$376                         |                                    | (\$30,376) <sup>(1)</sup> | (\$460,000 )             |
| Inventory Allowance For<br>Obsolescence And Excess<br>Quantities | (\$1,168,395)                  | (\$125,000)                   | (\$12,160 ) <sup>(3)</sup>         | \$ 205,691 (2)            | (\$1,099,864)            |

(1) Decrease (Increase) due to bad debt write-offs and recoveries.

(2) Decrease due to disposal of obsolete inventory.

(3) Increase due to inventory revaluation. The other account charged as a result of this revaluation was inventory before reserves. This did not result in a change to our net inventory or net income.

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**INDEX TO EXHIBITS**

| Exhibit<br>No. | Description  |
|----------------|--|
| 3.1            | Amended and Restated Certificate of Incorporation of the Registrant (filed as Exhibit 3(1) to the Company's Registration Statement on Form S-1, as amended, Registration No. 33-40128, filed with the Commission on May 8, 1991 (the "Registration Statement") and incorporated herein by reference)   |
| 3.2            | By-Laws of the Registrant (filed as Exhibit 3(2) to the Registration Statement and incorporated herein by reference)   |
| 10.1           | Employee Stock Purchase Plan (incorporated herein by reference to Exhibit 10(3) to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 1998)   |
| 10.2           | Allied Healthcare Products, Inc. 1995 Directors Non-Qualified Stock Option Plan (incorporated herein by reference to Exhibit 10(25) to the Company's Annual Report on Form 10-K filed for the fiscal year ended June 30, 1995)   |
| 10.3           | Form of Indemnification Agreement with officers and directors (incorporated herein by reference to Exhibit 10.22 to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2004)  |
| 10.4           | Employment Agreement dated February 28, 2007 by and between Allied Healthcare Products, Inc. and Earl Refsland (incorporated by reference to the Company's Current Report on Form 8-K filed March 16, 2007)  |
| 10.5           | Change of Control Agreement Employment Agreement dated March 16, 2007 by and between Allied Healthcare Products, Inc. and certain executive officers (incorporated by reference to the Company's Current Report on Form 8-K filed March 16, 2007)  |
| 10.6           | Allied Healthcare Products, Inc. 1999 Incentive Stock Plan (incorporated herein by reference to Exhibit 10(26) to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 1999)  |
| 10.7           | Agreement between Allied Healthcare Products, Inc. Medical Products Division and District No. 9 International Association of Machinists and Aerospace Workers dated August 1, 2000 through May 31, 2003 (incorporated herein by reference to Exhibit 10.28 to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2003 (the "2003 Annual Report")) |
| 10.8           | Loan and security agreement dated April 24, 2002 between the Company and LaSalle Bank National Association, including form of notes (incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2002)   |
| 10.9.1         | Amendment to Loan and security agreement dated September 26, 2002 (incorporated herein by reference to the Company's Current Report on Form 8-K, filed on October 1, 2002)   |
| 10.9.2         | Amendment to Loan and security agreement dated September 26, 2003 (incorporated herein by reference to Exhibit 10.30.2 to the 2003 Annual Report)  |
| 10.9.3         | Amendment to Loan and Security Agreement dated August 27, 2004 (incorporated herein by reference to Exhibit 10.30.3 to the Registrant's Annual Report on Form 10-K, filed on October 1, 2004 for the fiscal year ended June 30, 2004)  |
| 10.10          | Agreement dated August 27, 2004 between Allied Healthcare Products, Inc and Abbott Laboratories, Inc. (incorporated herein by reference to the Company's Current Report on Form 8-K filed August 30, 2004)   |



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| Exhibit No. | Description   |
|-------------|---|
| 21          | Subsidiaries of the Registrant (incorporated herein by reference to Exhibit 21 to the Company's Annual Report on Form 10-K filed on September 28, 2000 for the fiscal year ended June 30, 2000)                           |
| 22          | Allied Healthcare Products, Inc. 2009 Stock Incentive Plan (the 2009 Plan ) (incorporated herein by reference to the Company's Current Report on Form 8-K, filed September 2, 2009)                                       |
| 23          | Nonqualified Stock Option Agreement, by and between the Company and Earl R. Refsland, Awarded Under the 2009 Plan (incorporated herein by reference to the Company's Current Report on Form 8-K, filed September 2, 2009) |
| 23.1        | Consent of RubinBrown LLP (filed herewith)  |
| 24          | Form of Power of Attorney (filed herewith)  |
| 31.1        | Certification of Chief Executive Officer (filed herewith)   |
| 31.2        | Certification of Chief Financial Officer (filed herewith)   |
| 32.1        | Sarbanes-Oxley Certification of Chief Executive Officer*  |
| 32.2        | Sarbanes-Oxley Certification of Chief Financial Officer*  |

Notwithstanding any incorporation of this Annual Report on Form 10-K in any other filing by the Registrant, \*Exhibits designated with an asterisk (\*) shall not be deemed incorporated by reference to any other filing under the Securities Act of 1933 or the Securities Exchange Act of 1934 unless specifically otherwise set forth therein.

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