

# ***PACE Medical, Inc.***

## **2005 Annual Report**

**Discover the Difference <sup>TM</sup>**

***...product performance, dedication to quality and to the improvement of patient care. High Standards, no compromise to excellence, helping patients one day at a time.***

# ***Pace Medical, Inc.*** \_\_\_\_\_

## **Dear Shareholders:**

It is our pleasure to take this opportunity to update you on the events of 2005 and inform you of developments at Pace Medical. Additionally, we will provide information regarding management's plans for the future.

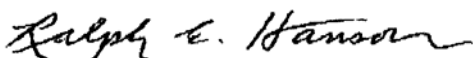
The Company increased sales 19 percent in 2005 compared to the previous year. The sales increase was due to two primary events. First, the Company was able to better align itself with key vendors for the supply of critical components. This decreased backorders and allowed for us to better meet customer demand. Additionally, our sales internationally increased substantially. This was mainly due to better performance in supplying product. However our main international selling arm was able to obtain key tenders and orders. While sales increased the Company did have an overall loss in earnings of 13 percent of sales. This was a 65 percent improvement over prior year.

Our wholly-owned United Kingdom subsidiary, APC Medical Ltd., continues to be profitable. The majority of the Company's overall sales increase came through product sold by APC Medical. Plans for APC Medical include manufacturing of additional product lines designed by Pace Medical. APC Medical is the sole manufacturer of temporary cardiac pacemakers, single-use and autoclavable surgical cables and a complete service/repair facility in the United Kingdom. This positions the Company well for supporting our international customers. Additionally, a Company representative is a member of the ISO standards committee regarding pacing products.

While 2005 was a strong rebuilding year, and our overall results improved, substantial efforts will be made in 2006 to further position the Company for growth. Preparing for the introduction of new products, continuing to develop close relationships with key vendors and adding state-of-the-art engineering development software and hardware capital resources, will better position Pace Medical for future growth and earnings potential. Management is confident that the products in development and relationships with customers that are in process, will further enhance our position as a key supplier of temporary pacemakers and pacing system analyzers.

We thank our valued shareholders for their continued support and confidence and look forward to your future involvement with Pace Medical.

Sincerely,



Ralph E. Hanson  
Chairman & Treasurer



Steven E. Hanson  
President & CEO

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# *Pace Medical, Inc.* \_\_\_\_\_

## **Corporate Profile**

Pace Medical, Inc. is positioned to be the only medical device company exclusively dedicated to designing and marketing a complete line of high-quality temporary cardiac pacing products to meet the expanding needs of the medical profession worldwide. Our products include both single and dual chamber temporary cardiac pacemakers, a dual-chamber pacing analyzer, autoclavable temporary pacemaker extension cables, disposable surgical extension cables and related accessories.

Our single-chamber temporary cardiac pacemakers include the Bedside™ model which attaches to the patient's bedrail and the Mini-Pacer product line which enable the patient to remain ambulatory during treatment. The Company's MICRO-PACE™, dual-chamber temporary cardiac pacemaker, is software programmable and capable of multi-parameter, multi-mode operation. It has the ability to sense and pace at high rates in the DDD mode; thereby, restoring A-V synchrony and improving cardiac output. The device will greatly assist the recovery of patients, regardless of age, who have very fast rates (180-210 bpm) and who have developed temporary heart block, following open-heart surgery.

The AccuPace™, dual-chamber pacing analyzer, combines the benefits of dual-chamber, multi-mode, multi-parameter pacing with testing features that evaluate, display and store important characteristics of the patient's lead system. The temporary pacing feature allows the physician to perform pre-implant stimulation studies of the basic pacing parameters and functions on the patient prior to the implantation of a permanent pulse generator. Once again, considerable attention has been paid to the "user-friendly" aspects of operation.

The Pace Line™ series of disposable products— shrouded pin surgical extension cables and adapters— are designed to enhance our ability to offer a complete line of highly-competitive temporary pacing products to our customers.

APC Medical Ltd., our wholly-owned subsidiary in the United Kingdom, is well-positioned to expand our business throughout the European Union (EU) and elsewhere in Europe, the Middle East, Indo/Asia and Latin America. Like Pace Medical, APC Medical offers a complete line of temporary cardiac pacing products and related accessories. A complete service/repair facility is provided by APC Medical to address the needs of the Company's many international customers.

At present, Pace Medical has production facilities in both the United States and the United Kingdom. Our products are sold to both North American and international markets through qualified, professional sales representatives.

# ***Pace Medical, Inc.*** \_\_\_\_\_

## **History and Background**

Your company operations began in March 1985, when we acquired APC Medical Ltd. From American Pacemaker Corporation, a wholly-owned subsidiary of Intermedics, Inc. APC Medical is the successor to Devices Ltd. (a former Johnson and Johnson company), a United Kingdom medical equipment manufacturer and pioneer in the pacing industry.

Our United Kingdom facility can accommodate extensive production expansion. Being located within the European Union (EU) also provides the Company with many international marketing advantages. Pace Medical's research and development is conducted at its corporate office in the United States.

## **Our Business**

### **Temporary Cardiac Pacemakers, Pacing Analyzer and Accessories**

Temporary cardiac pacemakers have three principal uses: therapeutic, prophylactic and diagnostic. The most common use is therapeutic. For example, when a patient is admitted to a hospital with an inadequate or grossly irregular heart rhythm, a pacemaker stabilizes the rhythm and improves the rate. Prophylactic use describes the application of a pacemaker to a patient as a precaution when their condition is unstable. This too is common. Finally, pacemakers, particularly those which are more sophisticated, serve a valuable purpose as a diagnostic tool; assisting a physician in making a diagnosis or simply evaluating a specific condition in a patient.

In the United Kingdom, APC Medical Ltd. Is the market leader for temporary cardiac pacemakers where we set the industry standard and supply the majority of the units sold. APC Medical is well known for its Bedside™ model pacemaker which attaches to the patient's bedrail. Additionally, the Company manufactures the MiniPacer line of temporary pacemakers which enable patients to remain ambulatory during treatment. A complete line of pacemaker autoclavable extension cables, surgical cables and accessories are also designed and manufactured at the facility.

Pace Medical manufactures the MICRO-PACE, dual chamber, temporary pacemaker, the AccuPace™ dual-chamber, pacing analyzer and provides design engineering, service/repair facilities, administration services, and sales and marketing to both companies.

# ***Pace Medical, Inc.*** \_\_\_\_\_

## **Reasons to use a Temporary Pacemaker**

- In an emergency to control cardiac rhythm until a pacemaker can be implanted.
- To stabilize a patient until drug therapy can take effect.
- During surgery to control heart rate, maintain A-V synchrony and increase cardiac output when necessary.
- After open-heart surgery until the heart recovers.
- To ascertain the thresholds for pacing and sensing on a permanent lead in the absence of a properly functioning pacing analyzer.
- To overdrive rapid Atrial arrhythmias so that sinus rhythm may be re-established.

## **Current Products**

### **MIRCO-PACE™ Model 4570**

The MICRO-PACE, dual chamber, temporary cardiac pacemaker utilizes a copyrighted software-based microprocessor design that is on the forefront of cardiac pacing technology. This design also provides the basis for the development of non-invasive electrical stimulation products.

This advanced design temporary pacemaker has the ability to sense, pace and track in the DDD mode at high-rates; thus allowing physicians to address the needs of post-operative, open-heart patients, regardless of their age. In particular, the device will greatly assist the recovery of both infants and young children, who have very fast atrial heart rates (180-210 bpm) and who have developed temporary heart block, following open-heart surgery.

The MICRO-PACE has a constant voltage output feature which greatly improves the ability to establish and maintain capture when using low impedance pacing leads such as heartwires. The amount of energy in micro joules delivered to the patient could be approximately three times that of constant current devices, thereby, preventing loss of capture.

# ***Pace Medical, Inc.*** \_\_\_\_\_

## **Bedside™ Model 4170**

The Bedside™ Model 4170, single-chamber temporary cardiac pacemaker, is housed in a rugged metal case and has a new generation, high-accuracy, digital electronic circuitry. The electronic modules are manufactured using the latest methods of surface mounted electronic assembly, at a state-of-the-art facility. The design features include control knobs for convenient, user-friendly operation, increased ranges for rate, output and sensitivity. In addition, it has a 15 volt maximum constant voltage output and a high-rate atrial pacing capability. A United States of America, Food and Drug Administration (FDA) cleared autoclavable extension cable with a universal patient connector is included with each Bedside. This cable eliminates the need for any adapters.

## **Mini-Pacer™ Model EV4543**

Mini-Pacer™ model EV4543 is a single-chamber temporary cardiac pacemaker designed to provide acute therapeutic, prophylactic and diagnostic pacing support. It is capable of operating in the demand or asynchronous mode and include adjustable rate, output and sensing controls. The EV4543 incorporates a rate-tripling (x3) control which provides for high-rate pacing up to 450 ppm for use in rapid atrial stimulation.

The EV4543 pacemaker has constant voltage outputs which are capable of delivering more energy to the patient than similar constant current devices. This feature provides a definite advantage in establishing and maintaining capture when encountering low stimulation impedance in pacing leads.

The EV4543 is powered by standard 9-volt batteries and is compatible with most endocardial and myocardial lead systems. The device comes complete with a carrying case, arm straps, FDA cleared autoclavable extension cable and instruction manual.

## **AccuPace™ Model 4800**

The AccuPace™ Model 4800, dual-chamber, pacing analyzer combines the benefits of dual-chamber, multi-mode, multi-parameter pacing with testing features that evaluate, display and store important characteristics of the patient's lead system.

# ***Pace Medical, Inc.*** \_\_\_\_\_

The temporary pacing feature allows the physician to perform pre-implant stimulation studies of the basic pacing lead parameters and functions on the patient prior to the implantation of a permanent pulse generator. Considerable attention has been paid to the design of this product in the “user-friendly” aspects of its operation.

The AccuPace™ comes in a carrying case along with two standard 9-volt batteries, a pair of FDA cleared autoclavable extension cables and an instruction manual.

## **Pace Line™ Pacing Cables and Adapters**

### **Temporary Cardiac Pacemaker Universal Extension Cables**

The Company designs, develops and manufactures all of its Temporary Cardiac Extension Cables. Our Extension Cables are FDA cleared for commercial sale. The Model 4265, 4265A and 4265V cables are approximately eight feet in length and are autoclavable. All cables on the patient end have molded, color-coded positive closure collet terminals in combination with color-coded, protected pin sockets. This allows for easy and reliable connection to heartwires or temporary pacing leads using 2 mm diameter shrouded connector pins, without the use of adapters.

The device end of the Extension Cable has a “booted” 2 mm connector pins that terminate in a molded, color-coded block positioned 1-1/4” on center. The molded silicone rubber “boots” slip over the pacemaker collet terminals during insertion. They freely rotate to tighten and/or loosen the collet terminals. All cables are designed for use with Pace Medical and APC Medical single and dual-chamber cardiac pacemakers. The Model 5265, 5265A and 5265V utilize a redel connector on the device end of the cable instead of the booted 2 mm diameter pins.

### **Temporary Pacing Analyzer Extension Cables**

The Company designs, develops and manufactures all of its Temporary Pacing Analyzer Cables. They come in a variety of types; including disposable, single-use cables or autoclavable re-useable, multi-use cables.

The Model 4250 disposable cable is 3.0 meters (10 feet) in length with color-coded 2 mm diameter shrouded connector pins on one end and alligator clips with insulating covers on the other end. They are packaged sterile, five per box. The Model 4255 and 4260 disposable cables utilize a redel connector on the device end and alligator clips or molded collet terminals on the other end for pacing lead connection.

# ***Pace Medical, Inc.*** \_\_\_\_\_

The Model 4280, 4280A and 4280V autoclavable, multi-user cables are 3 meters (10 feet) in length and bifurcated on one end using color-coded insulated alligator clips with 2 mm diameter connector pins in a molded, color-coded block positioned 1-1/4 " on center on the other end. The cables are provided with "booted" male connector pins. The molded silicone rubber "boots" slip over the caps of the collet terminals during connector pin insertion then freely rotate the boots to tighten and/or loosen the terminal caps. The Model 5280A and 5280V utilize a redel connector on the device end instead of booted 2 mm diameter connector pins.

## **Adapters**

The Company designs, develops and manufactures all of its adapters. The Model 4815 utilizes a Redel connector for connection to our disposable cables (Models 4255 and 4260). It can easily be attached to the collet terminals located on our Temporary Cardiac Pacemakers, Mini-Pacers Models EV4543 and MICRO-PACE™ 4570 as well as our AccuPace™, Model 4800, Pacing Analyzer.

With the Model 4825 universal adapter installed, the Model 4250 disposable surgical extension cable or temporary pacing leads, utilizing a 2 mm diameter shrouded pin connector design, can be connected easily to Pace Medical's temporary cardiac pacemakers or pacing analyzer. The universal adapter also includes collet terminal that allow for exposed pins (e.g. heartwires) to be readily connected to the pacing devices.

## **New Products**

The Company identified an opening niche market for its pacemaker system analyzer and began a project to update the AccuPace Model 4800, by adding state of the art surface mounted electronics and additional features for ease of use. It is planned to enter the market in early 2007.

The ***iPACE***™ Model 4900, is an all new pacemaker system analyzer, incorporating the latest features for products of this type. A key new feature includes intracardiac electrograms (IEGMs) which allows the physician to see electrical signals from inside the heart, to aid in diagnosis and placement of the pacing leads during permanent pacemaker or defibrillator placement.

# ***Pace Medical, Inc.*** \_\_\_\_\_

In addition, the Model 4900 will incorporate the latest in surface mounted electronics manufacturing and use state of the art components and software design. The Model 4900 is planned to enter the market in mid 2007.

Due to the continued demand for the Model 4570 MICRO-PACE and the development effort for the new AccuPace and ***iPACE***, the MICRO-PACE EP, Model 4580, dual-chamber, temporary cardiac pacemaker with increased function over its predecessor, was moved for introduction until the first quarter of 2007.

Pace Medical is currently developing and designing a new generation of pacing products that the Company plans to introduce in 2007. The Company has already introduced a new generation Bedside™ Model 4170 in 2004.

Several other new products are planned for distribution in 2007. The Company plans to provide to the medical community the Unifocal® Model 2100 and Bifocal® Model 2200, lines of single and dual-chamber temporary pacemakers, utilizing high-accuracy, digital electronic circuitry. The electronic modules are manufactured using the latest methods of surface mounted electronic assembly, at a state-of-the-art facility. The design features include control knobs for convenient, user friendly operation, increased ranges for rate, output and sensitivity, a 15 volt maximum constant voltage output and high-rate atrial pacing capability.

**PACE MEDICAL, INC. AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**  
**DECEMBER 31, 2005 AND 2004**

**ASSETS**

	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<b>CURRENT ASSETS:</b>			<b>CURRENT LIABILITIES</b>	
Cash and cash equivalents	\$ 502,944	\$ 902,198	Accounts payable	\$ 238,548
Accounts receivable	218,267	215,504	Accrued expenses	89,644
Inventories			Total current liabilities	328,192
Raw Materials	254,808	271,812		
Work in progress	75,530	119,876		
Finished goods	188,710	79,707		
Total Inventories	519,048	471,395	<b>SHAREHOLDERS' EQUITY:</b>	
			Common stock, \$.01 par value	34,009
			authorized 5,000,000	
Prepaid Expenses	29,531	39,309	Additional paid-in capital	3,147,151
			Accumulated other comprehensive income	210,414
Total current assets	1,269,790	1,628,406	Accumulated deficit	(2,155,794)
<b>PROPERTY AND EQUIPMENT</b>			Total shareholders' equity	1,235,780
Machinery and equipment	104,076	63,117		
Office furniture, equipment, and improvements	43,563	73,926	Treasury stock, at cost	(31,747)
Computer equipment	74,593	95,890	(46,000 shares in 2004 and 2005)	
Total property and equipment	222,232	232,933	Shareholders' equity - net	1,204,033
Less accumulated depreciation and amortization	(213,822)	(214,121)		
Property and equipment - net	8,410	18,812		
<b>OTHER ASSETS - Net</b>	254,025	248,626	<b>TOTAL LIABILITIES AND</b>	
<b>TOTAL ASSETS</b>	<b>\$1,532,225</b>	<b>\$ 1,895,844</b>	<b>SHAREHOLDERS' EQUITY</b>	<b>\$ 1,532,225</b>
				<b>\$ 1,895,844</b>

**PACE MEDICAL, INC. AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF OPERATION  
YEARS ENDED DECEMBER 31, 2005 AND 2004**

	<b>2005</b>	<b>2004</b>
TOTAL NET SALES	\$ 1,447,034	\$ 1,216,624
COST OF SALES	<u>633,993</u>	<u>664,402</u>
GROSS PROFIT	813,041	552,222
OPERATING EXPENSES		
Selling, general, and administrative	804,904	753,666
Engineering/development	<u>192,925</u>	<u>117,191</u>
LOSS FROM OPERATIONS	(184,788)	(318,635)
OTHER INCOME - Primarily interest	<u>38,745</u>	<u>23,754</u>
LOSS BEFORE INCOME TAX EXPENSE	(146,043)	(294,881)
INCOME TAX EXPENSE	<u>40,996</u>	<u>14,751</u>
NET LOSS	<u>\$ (187,039)</u>	<u>\$ (309,632)</u>
NET LOSS PER SHARE - Basic and diluted	<u>\$ (0.05)</u>	<u>\$ (0.09)</u>

# ***Pace Medical, Inc.*** \_\_\_\_\_

## **Market for Common Equity and Related Stockholder Matters**

The Company's Common Stock is quoted on the National Association of Securities Dealers, Inc.'s Pink Sheets under the symbol PMDL. The following table sets forth, for the periods indicated, the closing quote on the Pink Sheets. Such quotations reflect inter-dealer prices, without retail mark-up, mark-down, or commission and may not reflect actual transactions.

### Fiscal Year Ended December 31, 2004 (OTC)

First Quarter.....	\$	0.29
Second Quarter.....		0.26
Third Quarter.....		0.28
Fourth Quarter.....		0.28

### Fiscal Year Ended December 31, 2005 (Pink Sheets)

First Quarter.....	\$	0.34
Second Quarter.....		0.55
Third Quarter.....		0.31
Fourth Quarter.....		0.30

There are approximately 85 record holders of the Company's Common Stock.

The Company has never paid dividends and does not have any intention of paying dividends in the foreseeable future.

## **Trademarks of the Company**

The following trademarks are used by Pace Medical, Inc. and/or APC Medical Ltd.

MICRO-PACE™

AccuPace™

Unifocal®

Bifocal®

Bedside™

Mini-Pacer™

Pace Line™

***iPACE***™

Intermedics (UK) Ltd.®

Devices Ltd.®

# ***Pace Medical, Inc.*** \_\_\_\_\_

## **Pace Medical, Inc. and Wholly-Owned Subsidiary Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Financial Condition**

As of December 31, 2005, the Company had cash and cash equivalents of \$502,944 and working capital of \$944,598. This contrasts to comparable cash and working capital positions at December 31, 2004 of \$902,198 and \$1,268,231.

Management continues to believe that the current level of working capital, coupled with the flexibility of the Company's cost structure, should suffice to ensure that its on-going operations are financed adequately in fiscal 2006. However, in the short term additional equity and or debt financing may be sought to continue to fund research and development, inventories, capital equipment, facilities and to expand the Company's marketing operation.

### **Results of Operations— Year Ended December 31, 2005 Versus Year Ended December 31, 2004**

Sales increased from \$1,216,624 in 2004 to \$1,447,034, primarily due to an increase in the Company's international business.

Gross margins for 2005 were approximately 44%. This improvement over 2004 was due to the product mix, favorable production variances and an increase in sales.

Operating expenses increased from \$870,857 in 2004 to \$997,829 in 2005. This increase was primarily attributable to an increase in engineering and administration expenses.

The Company has reflected a tax provision of \$40,996 on its financial statements for 2005 representing taxes paid in the United Kingdom on APC Medical income. The Company lost, after taxes, approximately \$187,039 or \$0.05 per share for the year ended December 31, 2005. This contrasts with an after tax, 2004 loss of \$309,632 or \$0.09 per share.

# *Pace Medical, Inc.* \_\_\_\_\_

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2005 AND 2004

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### SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Consolidation** - The consolidated financial statements include the accounts of Pace Medical, Inc. and its subsidiary, APC Medical Ltd. ("APC"), a United Kingdom company ("Pace" or the "Company"). The Company manufactures and sells temporary external pacemakers, pacing system analyzers and related accessories to various customers throughout the world. All inter-company transactions, balances and profits are eliminated.

**Use of Estimates** - The preparation of consolidated financial statements in conformity with accounting principals generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**Product Liability and Limits of Insurance Coverage** - Because the Company's temporary cardiac pacemakers and pacing analyzers may be life-supporting medical devices, the Company's liability for any presently unknown product design or manufacturing deficiencies could be substantial and could exceed the limits under existing product liability insurance. The Company maintains product liability coverage outside the United States with annual limits of £1,000,000 (approximately \$1,720,000 as of December 31, 2005). The Company does not have product liability insurance in the United States. The Company believes, based upon management's experience, that its liability exposure is lessened because it does not manufacture or sell permanent cardiac pacemakers or leads. Management does not believe that any potential claims would therefore have a material impact on the financial condition or the results of operations.

**Revenue Recognition** - Sales are recognized when products are shipped, persuasive evidence of an arrangement exists, the sales price is fixed or determinable, and collectibility is reasonably assured. Historical experience has been such that no allowance for sales returns is currently provided.

**Cash and Cash Equivalents** - Cash and cash equivalents include highly liquid investments with remaining maturities of three months or less at the date of purchase.

# ***Pace Medical, Inc.*** \_\_\_\_\_

***Accounts Receivable*** - Accounts receivable are stated at the amount management expects to collect from outstanding balances. An allowance for doubtful accounts is provided for those accounts receivable considered to be uncollectible based upon historical experience and management's evaluation of outstanding accounts receivable at the year end. Historical experience has been such that no allowance for bad debts is currently provided.

***Inventories*** - Inventories are stated at the lower of cost (first-in, first-out method) or market.

***Property and Equipment*** - Property and equipment are stated at cost. Depreciation is recorded under the straight-line method based on the estimated useful lives of the related assets, ranging from three to seven years. Repairs and maintenance are expenses as incurred, while costs of betterments are capitalized. Depreciation expense was \$Z and \$20,705 for the years ended December 31, 2005 and 2004 respectively.

***Other Assets*** - Other assets consist of deferred tooling costs, including tooling costs for several new products. Such costs are amortized using the straight-line method, primarily over five years from the period of initial sale. Amortization expense for 2005 and 2004 aggregated approximately \$0.00 and \$37,862 at December 31, 2005 and 2004 respectively.

***Translation of Foreign Currencies*** - Assets and liabilities of APC are translated at exchange rates in effect on reporting dates, while income and expenses are translated at rates which approximate those in effect on the transaction dates (generally the average rate for the period). Differences due to changing exchange rates are charged or credited to accumulated other comprehensive income (loss) in shareholder's equity. Gains and losses from foreign currency transactions are included in net income.

***Income Taxes*** - Deferred taxes are provided for temporary differences between book and tax bases of the Company's assets and liabilities and loss and credit carryforwards based on tax rates and laws enacted as of the balance sheet date. The Company has provided a valuation allowance against net deferred tax assets due to uncertainty regarding the recoverability of tax carryforwards and other temporary differences.

***Warranty*** - The Company warrants its temporary cardiac pacemakers for one year. The Company records a liability for specific warranty matters when they become known and are reasonably estimable. The Company's product warranty obligations are included in accrued expenses. Currently the Company has no warranty reserves.

***Loss Per Share*** - The Company determines basic net loss per share using the weighted-average common shares outstanding for the year. The shares used to determine diluted net loss per share include the shares used in the calculation of the basic net loss per share plus dilutive weighted-average options and warrants outstanding during the year using the treasury-stock method.

***Comprehensive Loss*** - Comprehensive loss includes net loss and foreign currency translation adjustments.

# ***Pace Medical, Inc.*** \_\_\_\_\_

***Stock-Based Compensation*** - Compensation expense associated with awards of stock or options to employees is measured using the intrinsic-value method. Compensation associated with awards to non-employees is measured using the fair-value method. No stock compensation expense was recorded in 2005 and 2004. The Company did not grant any stock options in 2005.

The option-pricing model used was designed to value readily tradable stock options with relatively short lives. The options are not tradable with contractual lives of up to five years. However, management believes that the assumptions used to value the options and the model applied yield a reasonable estimate of fair value of the grants made under the circumstances.

***Concentration of Credit Risk*** - The Company sells its products primarily to a limited number of distributors. The Company requires no collateral from its distributors. In March 1990, the Company entered into an agreement with APC Cardiovascular Ltd. ("Cardiovascular"). This agreement specified that Cardiovascular would act as Pace's distributor in the United Kingdom. A director and significant shareholder of Cardiovascular is also a director of Pace. A significant percentage of Pace's sales are to Cardiovascular.

***Lease Obligations*** - APC leases its plant and office facility under a renewable operating lease which expires in 2006. The lease requires payment of a pro-rata share of insurance and maintenance costs in addition to the rental payment.

Pace is a tenant-at-will and has no lease agreement for its United States facility.

***Contingencies*** - The Company is engaged in legal proceedings arising in the ordinary course of business. We believe that the ultimate outcome of these proceedings will not have a material adverse impact on our consolidated financial position, results of operations or cash flows.

# ***Pace Medical, Inc.***

## **Board of Directors**

Ralph E. Hanson

*Chairman & Treasurer, Pace Medical, Inc.*

Steven E. Hanson

*President & Chief Executive Officer, Pace Medical, Inc.*

Derrick Ebden

*Managing Director, APC Cardiovascular Ltd., England*

George F. Harrington

*President, Boston Equity Management Company*

## **Corporate Officers**

Ralph E. Hanson

*Chairman & Treasurer*

Steven E. Hanson

*President & Chief Executive Officer*

Drusilla F. Hays

*Vice President & Clerk*

## **APC Medical Ltd., England**

Ralph E. Hanson

*Chairman*

Derrick Ebden

*Director*

Steven E. Hanson

*Director*

## **Counsel**

Lynch, Brewer, Hoffman & Fink, LLP

*Boston, Massachusetts 02110*

## **Auditor**

Maidment Judd

*United Kingdom*

## **Transfer Agent**

American Stock Transfer & Trust Company

*New York, New York 10022*

## **Investor relations**

Web site: [www.pacemedicalinc.com](http://www.pacemedicalinc.com)

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Pace Medical, Inc.  
391 Totten Pond Road  
Waltham, MA 02451

**Pink Sheets Symbol: PMDL**

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**Discover the Difference™**

***PACE Medical, Inc.***

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Website: [www.pacemedicalinc.com](http://www.pacemedicalinc.com)