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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2007

Commission File No. 000-22166

AETRIUM INCORPORATED
(Exact name of registrant as specified in its charter)

Minnesota	**41-1439182**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2350 Helen Street, North St. Paul, Minnesota	**55109**
(Address of principal executive offices)	(Zip Code)

(651) 770-2000
(Registrant's telephone number including area code)

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

Yes R No £

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

Large accelerated filer £ Accelerated filer £ Non-accelerated filer R

Indicate by a checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes £ No R

Number of shares of Common Stock, $.001 par value, outstanding on July 27, 2007 **10,430,336**

AETRIUM INCORPORATED

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

AETRIUM INCORPORATED

CONSOLIDATED BALANCE SHEETS
(Unaudited)
(in thousands, except share data)

ASSETS

	June 30, 2007	December 31, 2006
Current assets:		
Cash and cash equivalents	$ 8,660	$ 8,394
Accounts receivable, net	3,099	2,165
Inventories	7,860	7,363
Other current assets	411	336
Total current assets	20,030	18,258
Property and equipment:		
Furniture and fixtures	536	536
Equipment	1,286	1,268
	1,822	1,804
Less accumulated depreciation and amortization	(1,655)	(1,610)
Property and equipment, net	167	194
Other assets	423	415
Total assets	$ 20,620	$ 18,867

LIABILITIES AND SHAREHOLDERS' EQUITY

	June 30, 2007	December 31, 2006
Current liabilities:		
Current portion of long-term debt	$ 43	$ 41
Trade accounts payable	1,301	490
Accrued compensation	491	379
Other accrued liabilities	655	1,446
Total current liabilities	2,490	2,356
Long-term debt, less current portion	35	57
Commitments and contingencies		
Shareholders' equity:		
Common stock, $.001 par value; 30,000,000 shares authorized; 10,430,336 and 10,266,252 shares issued and outstanding, respectively	10	10
Additional paid-in capital	62,589	62,104
Accumulated deficit	(44,504)	(45,660)
Total shareholders' equity	18,095	16,454
Total liabilities and shareholders' equity	$ 20,620	$ 18,867

The accompanying notes are an integral part of the consolidated financial statements.

AETRIUM INCORPORATED

CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(in thousands, except per share data)

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Net sales	$ 5,866	$ 7,986	$ 10,971	$ 14,885
Cost of goods sold	2,912	3,876	5,327	7,369
Gross profit	2,954	4,110	5,644	7,516
Operating expenses:				
Selling, general and administrative	1,523	1,635	2,789	3,262
Research and development	912	831	1,888	1,687
Total operating expenses	2,435	2,466	4,677	4,949
Income from operations	519	1,644	967	2,567
Interest income, net	102	44	203	83
Income from continuing operations before income taxes	621	1,688	1,170	2,650
Income tax expense	9	19	14	26
Income from continuing operations	612	1,669	1,156	2,624
Loss from discontinued operations	—	(393)	—	(872)
Net income	$ 612	$ 1,276	$ 1,156	$ 1,752
Basic income (loss) per share:				
Continuing operations	$ 0.06	$ 0.17	$ 0.11	$ 0.27
Discontinued operations	—	(0.04)	—	(0.09)
Net income	$ 0.06	$ 0.13	$ 0.11	$ 0.18
Diluted income (loss) per share:				
Continuing operations	$ 0.06	$ 0.16	$ 0.11	$ 0.25
Discontinued operations	—	(0.04)	—	(0.08)
Net income	$ 0.06	$ 0.12	$ 0.11	$ 0.17
Weighted average common shares outstanding:				
Basic	10,394	9,980	10,336	9,899
Diluted	10,683	10,607	10,632	10,584

The accompanying notes are an integral part of the consolidated financial statements.

AETRIUM INCORPORATED

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(in thousands)

	Six months ended June 30,	
	2007	2006
Cash flows from operating activities:		
Net income	$ 1,156	$ 1,752
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	45	68
Amortization	3	142
Share-based compensation expense	146	38
Provision for excess and obsolete inventories	—	30
Changes in assets and liabilities:		
Accounts receivable	(934)	655
Inventories	(497)	(3,369)
Other current assets	(4)	(99)
Other assets	(142)	—
Trade accounts payable	811	868
Accrued compensation	112	358
Other accrued liabilities	(791)	799
Net cash provided by (used in) operating activities	(95)	1,242
Cash flows from investing activities:		
Purchase of property and equipment	(18)	(60)
Payment received on note receivable	60	—
Net cash provided by (used in) investing activities	42	(60)
Cash flows from financing activities:		
Proceeds from exercise of stock options	339	735
Payments on long-term debt	(20)	(17)
Net cash provided by financing activities	319	718
Net increase in cash and cash equivalents	266	1,900
Cash and cash equivalents at beginning of period	8,394	4,134
Cash and cash equivalents at end of period	$ 8,660	$ 6,034

The accompanying notes are an integral part of the consolidated financial statements.

AETRIUM INCORPORATED

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

In the opinion of management, the accompanying unaudited consolidated financial statements include all adjustments (consisting only of normal, recurring adjustments) necessary to present fairly the financial position, results of operations, and cash flows for the interim periods presented. The results of operations for the three and six months ended June 30, 2007 are not necessarily indicative of the operating results to be expected for the full year or any future period.

On December 31, 2006, as described in Note 5, we sold our product lines and operations located in Dallas, Texas. In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," results of those operations for the three and six months ended June 30, 2006 included in our consolidated statements of income have been reclassified and presented as discontinued operations.

The accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures, normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted, pursuant to such rules and regulations. Therefore, these financial statements should be read in conjunction with the consolidated financial statements and accompanying footnotes included in our Annual Report on Form 10-K for the year ended December 31, 2006.

2. SHARE-BASED COMPENSATION

In April 2007, a total of 508,000 stock options were granted to Aetrium employees and directors under our 2003 Stock Incentive Plan. All of the options granted have an exercise price of $3.87 per share, the fair market value on the date of grant. All of the options vest in monthly increments over four years and will expire five years after the grant date. Using the Black-Scholes valuation model, the weighted average fair value of the options granted was determined to be $1.74 per share.

The following weighted average assumptions were used in applying the Black-Scholes option-pricing model to estimate the fair value of stock options granted:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Expected stock price volatility	56%	59%	56%	59%
Risk-free interest rate	4.5%	5.0%	4.5%	5.0%
Expected dividend level	0%	0%	0%	0%
Expected life of options (years)	3.5	3.5	3.5	3.5

Share-based compensation expense included in our consolidated statements of income was as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Cost of goods sold	$ 12	$ 3	$ 19	$ 5
Selling, general and administrative	66	12	102	22
Research and development	16	2	25	4
Loss from discontinued operations	—	4	—	7
Total share-based compensation expense	$ 94	$ 21	$ 146	$ 38

As of June 30, 2007, we had approximately $1.5 million of unrecognized pretax share-based compensation expense, net of estimated forfeitures, which is expected to be recognized over 4.0 years.

3. INCOME (LOSS) PER COMMON SHARE

Basic income (loss) per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during each period. Diluted income (loss) per share is computed by dividing net income (loss) by the weighted-average number of common shares and common equivalent shares outstanding during each period. Common equivalent shares include stock options using the treasury stock method. A reconciliation of the number of shares used in the computations of basic and diluted income (loss) per share follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Weighted average common shares outstanding	10,394	9,980	10,336	9,899
Potentially dilutive stock options	289	627	296	685
Weighted average common shares outstanding, assuming dilution	10,683	10,607	10,632	10,584

For the three and six month periods ended June 30, 2007, options to purchase approximately 291,000 common shares are excluded from the computations because their exercise prices exceeded the average market value of our common stock for the periods and they would therefore be antidilutive to earnings per share.

4. RECENT ACCOUNTING PRONOUNCEMENT

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, “Fair Value” (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 becomes effective for fiscal years beginning after November 15, 2007. We do not expect the implementation of SFAS 157 to have a material impact on our financial position or results of operations.

5. DISCONTINUED OPERATIONS

On December 31, 2006, we sold the product lines being manufactured at our Dallas, Texas facility. The primary products included in the sale were our burn-in board loaders and turret-based test handlers. The sale transaction is fully described in Note 3 to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006.

The product lines and Dallas operations were sold to WEB Technology, Inc. (WEB), a privately held company. In connection with the sale, WEB agreed to pay Aetrium $522,000 plus 5% interest in quarterly installments over two years with the first installment payment due April 30, 2007. The current portion of the note receivable from WEB ($259,000) is included in the caption “Other current assets” and the long-term portion ($203,000) is included in the caption “Other assets” in our consolidated balance sheet at June 30, 2007.

Operating results related to the divested operations for the three and six months ended June 30, 2006, which have been reclassified and presented in our consolidated statements of income as discontinued operations, are summarized below (in thousands):

	Three months ended June 30, 2006	Six months ended June 30, 2006
Net sales	$ 718	$ 1,306
Cost of goods sold	438	780
Gross profit	280	526
Operating expenses	673	1,398
Loss from discontinued operations	$ (393)	$ (872)

No income tax benefit was allocated to the loss from discontinued operations because continuing operations had existing net operating loss carryforwards available to offset the pretax income.

6. IDENTIFIABLE INTANGIBLE ASSETS, NET

Identifiable intangible assets are included in the caption, "Other assets" in our consolidated balance sheet and are comprised of the following (in thousands):

	June 30, 2007			December 31, 2006		
	Gross	Accumulated amortization	Net	Gross	Accumulated amortization	Net
Developed technology	$ 200	$ (200)	$ —	$ 200	$ (200)	$ —
Core technology	567	(567)	—	567	(567)	—
Other	95	(95)	—	95	(92)	3
Total	$ 862	$ (862)	$ —	$ 862	$ (859)	$ 3

Amortization expense related to identifiable intangible assets included in our statements of income was as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Continuing operations	$ 1	$ 2	$ 3	$ 5
Discontinued operations	$ —	$ 28	$ —	$ 137

7. INVENTORIES

Inventories are comprised of the following (in thousands):

	June 30, 2007	December 31, 2006
Purchased parts and completed subassemblies	$ 3,719	$ 3,044
Work-in-process	1,870	1,847
Finished goods	2,271	2,372
Equipment shipped, subject to revenue deferral	—	100
Total	$ 7,860	$ 7,363

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8. OTHER ACCRUED LIABILITIES

Other accrued liabilities are comprised of the following (in thousands):

	June 30, 2007	December 31, 2006
Accrued commissions	$ 88	$ 6
Accrued severance and other related costs	138	645
Accrued warranty and no-charge equipment improvements	130	366
Customer deposits and deferred revenue	5	199
Other	294	230
Total	$ 655	$ 1,446

On December 31, 2006, we accrued $645,000 for costs related to the sale of our Dallas, Texas operations to WEB Technology, Inc. (WEB) described in Note 5. As part of the sale transaction, we agreed to reimburse WEB for wages and related costs through March 31, 2007 for 20 employees who transferred to WEB concurrently with the sale, at an estimated cost of $360,000. We also terminated 8 other employees for whom severance and related costs amounted to approximately $285,000. Payments related to these obligations amounted to $507,000 during the six months ended June 30, 2007. We estimate that the remaining accrual of $138,000 at June 30, 2007 will be paid at a rate of approximately $23,000 per quarter through December 2008.

The following table summarizes warranty and no-charge equipment improvement activity for the six months ended June 30, 2007 (in thousands):

Accrual balance, December 31, 2006	$ 366
Provisions for warranties and no-charge equipment improvements	60
Settlements	(296)
Accrual balance, June 30, 2007	$ 130

9. CREDIT AGREEMENT AND LONG-TERM DEBT

In October 2005, we entered into a revolving credit line agreement with a bank that provides for borrowings up to the lesser of $2.0 million or 90% of eligible accounts receivable plus 75% of eligible inventories and bears interest at the prime rate plus 0.25%. The agreement is collateralized by substantially all of our assets and provides that we maintain certain financial covenants. The initial credit agreement provided for a term of one year and in October 2006 it was extended for an additional year with the same terms and conditions. As of June 30, 2007, there were no borrowings under the line of credit agreement and we were in compliance with all covenants under the agreement.

In 2004, we executed a note payable to a bank for $190,000, payable in monthly installments of $3,966 through March 2009. The note is collateralized by certain data processing equipment and bears interest at the prime rate plus 1.5% with a minimum loan interest rate of 5.5% and maximum rate of 7.5% (the prime interest rate was 8.25% at June 30, 2007). The loan balance at June 30, 2007 was $77,711. Future maturities of long-term debt as of June 30, 2007 are as follows (in thousands):

2007 (six months)	$ 21
2008	45
2009	12
Total	$ 78

10. VACATED FACILITIES AND RELATED LEASE OBLIGATIONS

In connection with the sale of our Dallas, Texas operations to WEB Technology, Inc. (WEB) on December 31, 2006, as discussed in Note 5, the lease related to our Dallas facility was assigned to WEB. We remain contingently liable for the remaining lease payments, which total approximately $122,000 at June 30, 2007, if WEB were to default.

In 2000, we vacated a leased facility in Poway, California. The lease expires in January 2010. This facility is subleased to two independent parties with the sublease terms running concurrently with our remaining lease term. We remain contingently liable for the remaining lease payments, which total approximately $1.4 million at June 30, 2007, if either or both of the subtenants were to default.

As indicated above, the vacated facilities in Dallas, Texas and Poway, California are occupied by tenants who are under contract through the remainder of our lease terms. We believe the lease assignment and sublease income, including scheduled sublease rent increases, will cover our remaining lease obligations. However, if WEB were to default on the Dallas lease and/or if one or more of the Poway subtenants were to default on their sublease agreements we may have to record charges related to our future obligations under these leases.

11. STOCK OPTION PLANS

The following table summarizes activity under our stock incentive plans for the six months ended June 30, 2007:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contract Term	Aggregate Intrinsic Value (in thousands)
Outstanding, January 1, 2007	1,486,952	$ 3.09		
Granted	508,000	3.87		
Exercised	(174,692)	2.18		
Forfeited	(4,921)	2.98		
Outstanding, June 30, 2007	1,815,339	$ 3.39		
Options at June 30, 2007:				
Exercisable and expected to become exercisable	1,779,032	$ 3.39	3.3 years	$ 1,880
Exercisable	1,010,542	$ 3.05	2.3 years	$ 1,420

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between Aetrium's closing stock price on June 30, 2007 and the option exercise price) of all in-the-money stock options that would have been received by the option holders had they exercised their options on June 30, 2007. The total intrinsic value of options exercised during the six months ended June 30, 2007 was $312,000. The total fair value of options vested during the six months ended June 30, 2007 was $146,000.

The following table summarizes information related to stock options outstanding at June 30, 2007, all of which are nonqualified options and expire five years after the grant date and of which 299,500 options were fully exercisable when granted, 562,692 options were initially scheduled to become exercisable over four years from date of grant and were subsequently modified in 2005 to become fully exercisable to the extent not then exercisable, and 953,147 options become exercisable over four years from date of grant:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.87 to 1.03	25,000	0.4 years	$ 0.95	25,000	$ 0.95
2.76 to 3.13	990,964	2.4 years	2.91	850,755	2.90
3.87 to 4.81	799,375	4.4 years	4.07	134,787	4.44
$0.87 to 4.81	1,815,339	3.3 years	$ 3.39	1,010,542	$ 3.05

12. INCOME TAXES

We record the benefit we will derive in future accounting periods from tax losses and credits and deductible temporary differences as “deferred tax assets” on our balance sheet. Since 2000, we have maintained a valuation allowance to fully reserve these assets. We recorded the valuation allowance in 2000 because the cumulative losses we had incurred over the previous three years made it questionable whether we would realize value from the deferred tax assets. We assess the realizability of our deferred tax assets and the need for this valuation allowance in accordance with SFAS No. 109. We expect to continue to maintain a full valuation allowance until we determine that we can sustain a level of profitability that demonstrates our ability to use these assets. To the extent we determine that the realization of some or all of these benefits is more likely than not based upon expected future taxable income, a portion or all of the valuation allowance will be reversed. Such a reversal would be recorded as an income tax benefit and, for some portion related to deductions for stock option exercises, an increase in shareholders' equity. We recorded income tax expense of $9,000 and $14,000 in the three and six months ended June 30, 2007, respectively, and $19,000 and $26,000 in the three and six months ended June 30, 2006, respectively, for estimated federal alternative minimum tax and certain state minimum fees.

AETRIUM INCORPORATED

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

On December 31, 2006, as discussed in Note 5 to our unaudited consolidated financial statements, we sold our product lines and operations located in Dallas, Texas. Operating results related to those operations for the three and six months ended June 30, 2006 have been reclassified and presented as discontinued operations. Unless otherwise indicated, the following management discussion and analysis refers to continuing operations only.

Overview

Aetrium designs, manufactures and markets a variety of electromechanical equipment used in the handling and testing of integrated circuits, or ICs, which constitute the highest revenue component of the semiconductor industry. Our primary focus is on high volume ICs and on the latest IC package designs. Our products are purchased primarily by semiconductor manufacturers and their assembly and test subcontractors and are used in the test, assembly and packaging, or TAP, segment of semiconductor manufacturing. Our products automate critical functions to improve manufacturing yield, raise quality levels, increase product reliability and reduce manufacturing costs.

The semiconductor equipment industry is often described as a cyclical growth industry characterized by a long-term growth trend occasionally interrupted by periods of contraction and significant declines in revenue. General industry conditions and the demand for Aetrium's products can fluctuate significantly from period to period as a result of numerous factors, including but not limited to changes in U.S. and worldwide economic conditions, supply and demand for ICs, changes in semiconductor manufacturing capacity, advancements in industry technologies and competitive factors.

Following a period of generally weak business conditions that began in late 2004 and continued into 2005, semiconductor industry conditions steadily improved in the second half of 2005 as manufacturers experienced improving demand for semiconductors, decreasing inventory levels and improving capacity utilization rates. This led to improved business conditions for many semiconductor equipment suppliers as well. Worldwide bookings for the TAP segment of the semiconductor equipment industry improved substantially in the second half of 2005 and continued to be favorable in the first half of 2006. Aetrium's order activity and revenues were strong during this period and our net sales increased significantly to $6.9 million and $8.0 million in the first two quarters of 2006, respectively. Our revenues further increased to $8.2 million in the third quarter of 2006. Although our revenues increased sequentially in the third quarter of 2006, our new order activity decreased significantly from second quarter levels, which was consistent with generally weakening demand for equipment in the TAP segment of the semiconductor equipment industry. Order activity remained weak in the fourth quarter of 2006, and our revenues decreased to $5.1 million, or 38% below third quarter levels.

Semiconductor industry conditions continued to be relatively weak in the first half of 2007 as many manufacturers addressed inflated inventories and under-utilized capacity and continued to be very cautious regarding capital expenditures. It appears that the softness in the industry is not broad-based and that the supply/demand ratio has improved for some semiconductor device types, but not for others. We experienced increased order activity in the first half of 2007 for some of our test handler models, particularly those that are used in analog device-type applications. Our total net sales were $5.1 million in the first quarter and increased to $5.9 million in the second quarter of 2007. Although our orders and net sales increased in the first half of 2007 compared with fourth quarter 2006 levels, our total sales for the first half of 2007 were still significantly lower than our net sales in the first half of 2006. In the short term, we expect semiconductor manufacturers will continue to be cautious regarding capital expenditures and it is uncertain how long the softness in our

industry will continue. There can be no assurance that changes in semiconductor industry conditions, general domestic and global economic conditions, and/or other factors will not adversely impact Aetrium's future operating results.

Critical Accounting Policies and Estimates

Management's discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions. We believe the critical accounting policies that require the most significant judgments and estimates used in the preparation of our consolidated financial statements are those related to share-based compensation, revenue recognition, accounts receivable, inventories, warranty obligations and income tax accounting.

Share-Based Compensation
We account for share-based compensation in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" (SFAS 123R), which requires the measurement and recognition of all share-based compensation under the fair value method. We determine the fair value of share-based awards on the grant date by using the Black-Scholes option valuation model. We also use the Black-Scholes model to determine the fair value of modifications to awards by determining and comparing the fair value of the modified award with the fair value of the award immediately before the modification. Option valuation models, including Black-Scholes, require the input of subjective assumptions, and changes in the assumptions used can materially affect the calculation of the fair value of an award. These assumptions include expected stock price volatility, risk-free interest rate, expected dividend yield, and the expected life of the award. We estimate future stock price volatility based primarily on historical daily stock price observations of our common stock. Risk-free interest rate is estimated based on U.S. Treasury bill rates consistent with the expected term of an award. We assume an expected dividend yield of zero based on our intention to retain any future earnings for use in our operations. Expected life of an award is estimated primarily based on vesting provisions, the contractual term of the award, and historical experience of previous awards with similar terms or, if appropriate in the circumstances, we use the simplified method for estimating the expected life of an award, as permitted by Staff Accounting Bulletin No. 107. SFAS 123R also requires that estimated forfeitures be considered in the calculation of future compensation expense at the date of grant. We use historical data, as adjusted if deemed appropriate, to estimate future option forfeiture rates for purposes of recognizing share-based compensation expense.

Revenue Recognition
Our policy is to recognize revenue on product sales upon shipment if contractual obligations have been substantially met, collection of the proceeds is assessed as being reasonably assured, and title and risk of loss have passed to the customer, which is generally the case for sales of spare parts, accessories, change kits and some equipment and equipment upgrades. In instances where title does not pass upon shipment, revenue is recognized upon delivery or customer acceptance based upon the terms of the sales agreement. In instances where equipment or equipment upgrade sales contracts include significant post-shipment obligations to be performed by Aetrium, revenue for the entire transaction is deferred until such obligations have been completed or, if applicable, the transaction is accounted for as a multiple-element arrangement. For arrangements containing multiple elements, the amounts allocated to delivered and undelivered elements are based on their fair value and revenue is recognized upon delivery of each element. In instances where contractual terms can only be satisfied after shipment, such as meeting customer-specified acceptance requirements at the customer's site, revenue is not

recognized until there is objective evidence that the applicable contract terms have been met. Due to the high selling prices of certain types of equipment, the timing of revenue recognition of a relatively small number of transactions may have a significant impact on our quarterly results.

Accounts Receivable
We maintain an allowance for doubtful accounts that reflects our estimate of losses that may result from the uncollectibility of accounts receivable. Our allowance for doubtful accounts is based primarily on an analysis of individual accounts for which we have information indicating the customer may not be able to pay amounts owed to us. In these cases, based on the available facts and circumstances, we estimate the amount that will be collected from such customers. We also evaluate the collectibility of our accounts receivable in the aggregate based on factors such as the aging of receivable amounts, customer concentrations, historical experience, and current economic trends and conditions. We adjust our allowance for doubtful accounts when additional information is received that impacts the amount reserved. If circumstances change, our estimates of the recoverability of accounts receivable could be reduced or increased by a material amount. Such a change in estimated recoverability would be accounted for in the period in which the facts that give rise to the change become known.

Inventories
We adjust our inventories for estimated excess and obsolete inventory equal to the difference between the cost of inventory and its estimated realizable value based upon assumptions about future product demand and market conditions. If actual product demand or market conditions are less favorable than those projected by management, additional inventory adjustments may be required.

Warranty Obligations and Equipment Improvement Costs
We accrue estimated warranty costs in the period that the related revenue is recognized. Our warranty cost estimates and warranty reserve requirements are determined based upon product performance, historical warranty experience and costs incurred in addressing product performance issues. Should product performance or cost factors differ from our estimates, adjustments to our warranty accrual may be required. On occasion, we may provide no-charge equipment improvements for customers at our discretion. Such costs are accrued when identified, quantified and approved by management.

Income Tax Accounting
We record the benefit we will derive in future accounting periods from tax losses and credits and deductible temporary differences as “deferred tax assets” on our balance sheet. These deferred tax assets are reduced by a valuation allowance when we believe it is more likely than not that some portion or all of the deferred tax assets will not be realized. Since 2000, we have maintained a valuation allowance to fully reserve these assets. We recorded the valuation allowance in 2000 because the cumulative losses we had incurred over the previous three years made it questionable whether we would realize value from the deferred tax assets. We assess the realizability of our deferred tax assets and the need for this valuation allowance in accordance with Statement of Financial Accounting Standards No. 109, “Accounting for Income Taxes.” We expect to continue to maintain a full valuation allowance until we determine that we can sustain a level of profitability that demonstrates our ability to use these assets. To the extent we determine that the realization of some or all of these benefits is more likely than not based upon expected future taxable income, a portion or all of the valuation allowance will be reversed. Such a reversal would be recorded as an income tax benefit and, for the portion related to deductions for stock option exercises, an increase in shareholders' equity.

Results of Operations

Net Sales. Total net sales for the six months ended June 30, 2007 were $11.0 million compared with $14.9 million for the same period in 2006, a 26% decrease. Total net sales for the three months ended June 30, 2007 were $5.9 million compared with $8.0 million for the same period in 2006, a 27% decrease. Net sales of test handlers were $6.9 million in the first half of 2007 compared with $12.1 million in the first half of 2006, a

decrease of 43%. The decrease in test handler sales in 2007 is attributed to a general weakness in the TAP segment of the semiconductor equipment industry that developed in the second half of 2006 and continued into 2007. The decrease in test handler sales was partially offset by an increase in sales of reliability test equipment. Sales of reliability test equipment, which can fluctuate significantly from period to period due to the small numbers of unit sales, increased to $2.2 million in the first half of 2007 compared with $0.5 million in the first half of 2006. Sales of change kits and spare parts were $1.9 million in the first half of 2007 compared with $2.3 million for the same period in 2006, a decrease of 15%.

Gross Profit. Gross profit was 51.4% of net sales for the six months ended June 30, 2007 compared with 50.5% of net sales for the comparable period in 2006. Gross margin increased in 2007 primarily due to changes in product mix, partially offset by inefficiencies associated with lower production and revenue levels. Sales of reliability test equipment, which are generally higher margin sales, represented 20% of total sales in the first half of 2007 compared with 4% for the same period in 2006. Sales of spare parts and change kits, which are also generally higher margin sales, were 18% of total sales in the first half of 2007 compared with 15% for the same period in 2006. Sales of test handlers, which typically generate lower margins than our other product lines, represented 62% of total net sales in the first half of 2007 compared with 81% for the comparable period in 2006. Gross profit was 50.4% of net sales for the three months ended June 30, 2007 compared with 51.5% of net sales for the comparable period in 2006. The margin decrease in the second quarter of 2007 was attributable to inefficiencies associated with lower production and revenue levels and a less favorable product mix.

Selling, General and Administrative. Selling, general and administrative expenses for the six months ended June 30, 2007 were $2.8 million compared with $3.3 million for the comparable period in 2006, a 15% decrease. Selling, general and administrative expenses for the three months ended June 30, 2007 were $1.5 million compared with $1.6 million for the comparable period in 2006, a 7% decrease. The decreases in 2007 are primarily attributed to reduced commissions and warranty expenses associated with lower sales volume and lower no-charge equipment improvement costs.

Research and Development. Research and development expenses were $1.9 million for the six months endedJune 30, 2007, compared with $1.7 million for the same period in the prior year, an increase of 12%. Research and development expenses for the three months ended June 30, 2007 were $0.9 million compared with $0.8 million for the comparable period in 2006, a 10% increase. The increases are primarily attributed to increased wages and related costs associated with a slight increase in the number of engineering personnel over fiscal year 2006. Research and development expenses represented 17.2% and 11.3% of total net sales for the six months ended June 30, 2007 and 2006, respectively. New product development is an essential part of our strategy to gain market share. Over time, we expect to invest approximately 12% to 15% of our revenues in research and development although we may exceed this range during periods of reduced sales, as has been the case in 2007.

Interest Income, net. Interest income (expense), net, amounted to $203,000 and $83,000 in the six month periods ended June 30, 2007 and 2006, respectively, and $102,000 and $44,000 in the three month periods ended June 30, 2007 and 2006, respectively. These amounts consisted primarily of interest income from the investment of excess funds. Interest income increased in 2007 compared with the prior year primarily due to higher average cash balances.

Income Taxes. We recorded income tax expense of $14,000 and $26,000 in the six months ended June 30, 2007 and 2006, respectively, and $9,000 and $19,000 in the three months ended June 30, 2007 and 2006, respectively, related to estimated federal and state alternative minimum income taxes and state franchise taxes. Since 2000, we have maintained a valuation allowance to fully reserve our deferred tax assets. We recorded the valuation allowance in 2000 because the cumulative losses we had incurred over the previous three years made it questionable whether we would realize value from the deferred tax assets. We continue to monitor the realizability of the benefits related to

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our net deferred tax assets. To the extent we determine that the realization of some or all of these benefits is more likely than not based upon expected future taxable income, a portion or all of the valuation allowance will be reversed. Such a reversal would be recorded as an income tax benefit and, for the portion related to deductions for stock option exercises, as an increase in shareholders' equity.

Financial Condition, Liquidity and Capital Resources

Cash and cash equivalents increased by approximately $0.3 million in the six months ended June 30, 2007. We used $0.1 million to fund operating activities during this period. The major components of cash flows used by operating activities were a $0.9 million increase in accounts receivable, a $0.5 million increase in inventories, a $0.1 million increase in other assets, and a $0.7 million decrease in accrued liabilities, partially offset by net income of $1.2 million, $0.2 million in non-cash depreciation, amortization and share-based compensation expense, and a $0.8 million increase in accounts payable. Accounts receivable increased primarily due to the higher net sales level in the second quarter of 2007 compared with the fourth quarter of 2006. Inventories and accounts payable increased as we increased purchases to support anticipated sales levels, demo equipment needs, and customer delivery requirements. The decrease in other accrued liabilities includes the payment of $0.5 million in severance and related costs associated with the sale of our Dallas operations, a $0.2 million decrease in accrued warranty and no-charge equipment improvements expense, and a $0.2 million decrease in deferred revenue. Net cash generated by investing activities in the six months ended June 30, 2007 was not significant. Net cash provided by financing activities in the six months ended June 30, 2007 amounted to $0.3 million, consisting primarily of proceeds from employee stock option exercises.

Cash and cash equivalents increased by approximately $1.9 million in the six months ended June 30, 2006. We generated $1.2 million from operating activities during this period. The major components of cash flows generated by operating activities were net income of $1.8 million, $0.3 million in non-cash depreciation, amortization and share-based compensation expense, a $0.7 million decrease in accounts receivable, a $0.9 million increase in accounts payable, and a $1.2 million increase in accrued liabilities, partially offset by a $3.4 million increase in inventories. Accounts receivable decreased despite an increase in net sales due in part to shipments being more evenly distributed throughout the second quarter of 2006 compared with the fourth quarter of 2005 when shipments were more concentrated in the latter part of the quarter. Accounts payable increased primarily due to an increase in inventory purchases to support continued strong order and quotation activity. The increase in accrued liabilities included a $0.7 million increase in customer deposits and deferred revenue related to payments received for test handler systems for which revenue recognition criteria had not been met as of June 30, 2006 and a $0.4 million increase in accrued compensation based on profit levels achieved in 2006. Inventories increased due to an increase in purchases to support continued strong order and quotation activity as well as a $1.2 million increase in shipped equipment inventory subject to revenue deferral. Net cash used in investing activities in the six months ended June 30, 2006 amounted to $0.1 million for capital expenditures. During the six months ended June 30, 2006, we received $0.7 million in proceeds from employee stock option exercises.

Historically we have supported our capital expenditure and working capital needs with cash generated from operations and our existing cash and cash equivalents. We believe our cash and cash equivalents of $8.7 million at June 30, 2007 will be sufficient to meet capital expenditure and working capital needs for at least the next twelve months. In addition, we have a revolving credit line agreement with a bank that provides for borrowings up to the lesser of $2.0 million or 90% of eligible accounts receivable plus 75% of eligible inventories. The credit agreement expires in October 2007. We believe we will be able to extend the agreement at that time or obtain similar financing, if needed. However, there can be no assurance that such financing will be available with terms favorable to us or at all. In addition, a prolonged continuation of the generally weak business conditions in our industry or future industry downturns could negatively impact the demand for and prices of our products and adversely affect future cash flows. Also,

we may acquire other companies, product lines or technologies that are complementary to our business, and our working capital needs may change as a result of such acquisitions.

Recent Accounting Pronouncement

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, "Fair Value" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 becomes effective for fiscal years beginning after November 15, 2007. We do not expect the implementation of SFAS 157 to have a material impact on our financial position or results of operations.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our exposure to interest rate risk relates primarily to our short-term investment of excess funds which, as of June 30, 2007, consisted primarily of money market funds and bank certificates of deposit with original maturities of less than three months. Given the short duration of our investments and the size of our investment portfolio, we do not believe a change in interest rates would have a significant impact on our financial condition or results of operations. We generally conduct business in U.S. dollars and, therefore, risks associated with changes in foreign currency rates are insignificant.

Item 4. Controls and Procedures

Our President and Chief Executive Officer, our Chief Administrative Officer and our Treasurer conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e)) as of June 30, 2007. Based on their evaluation, they concluded that our disclosure controls and procedures were effective and designed to give reasonable assurance that the information required to be disclosed by us in reports that we file or submit under the Exchange Act was made known to them by others and was recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. There was no change in our internal controls that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to affect, our internal controls over financial reporting.

AETRIUM INCORPORATED

PART II. OTHER INFORMATION

Item 1. Legal Proceedings