

SPO Medical Inc  
Form 10QSB  
November 05, 2007

**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-QSB**

**MARK ONE**

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period ended September 30, 2007; 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: 0-11772*

**SPO MEDICAL INC.**

(Exact name of small business issuer as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation or organization)

25-1411971  
(I.R.S. Employer Identification No.)

**Beit Hapa'amon, Suite 209, 20 Hata'as Street, Kfar Saba, Israel**

(Address of principal executive offices, including zip code)

**972 9 764-3570**

(Issuer's telephone number, including area code)

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

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

As of November 5, 2007, SPO Medical Inc. had outstanding 20,979,969 shares of common stock, par value \$0.01 per share.

Transitional Small Business Disclosure Format (Check one) Yes  No

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## **FORWARD LOOKING STATEMENTS**

The following discussion and explanations should be read in conjunction with the financial statements and related notes contained elsewhere in this quarterly report on Form 10-QSB. Certain statements made in this discussion are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements can be identified by terminology such as "may", "will", "should", "expects", "intends", "anticipates", "believes", "estimates", "predicts", or "continue" or the negative of these terms or other comparable terminology and include, without limitation, statements below regarding: the Company's intended business plans; expectations as to product performance; intentions to acquire or develop other technologies; and belief as to the sufficiency of cash reserves. Because forward-looking statements involve risks and uncertainties, there are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements. Although the Company believes that expectations reflected in the forward-looking statements are reasonable, it cannot guarantee future results, performance or achievements. Moreover, neither the Company nor any other person assumes responsibility for the accuracy and completeness of these forward-looking statements. The Company is under no duty to update any forward-looking statements after the date of this report to conform such statements to actual results.

(ii)

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**SPO MEDICAL INC.  
AND ITS SUBSIDIARY  
CONDENSED INTERIM CONSOLIDATED BALANCE SHEET  
U.S. dollars in thousands**

**September 30,  
2007  
Unaudited**

**ASSETS**

**CURRENT ASSETS**

|  |    |       |
|--|----|-------|
| Cash and cash equivalents                      | \$ | 1,623 |
| Trade receivables                              |    | 1,010 |
| Other accounts receivable and prepaid expenses |    | 180   |
| Inventories                                    |    | 993   |
|  |    | 3,806 |

**LONG-TERM INVESTMENTS**

|                    |  |     |
|--------------------|--|-----|
| Deposits           |  | 12  |
| Severance pay fund |  | 283 |
|                    |  | 295 |

**PROPERTY AND EQUIPMENT, NET**

120

|                     |           |              |
|---------------------|-----------|--------------|
| <b>Total assets</b> | <b>\$</b> | <b>4,221</b> |
|---------------------|-----------|--------------|

**LIABILITIES AND STOCKHOLDERS' DEFICIENCY**

**Current Liabilities**

|                                     |    |       |
|-------------------------------------|----|-------|
| Short-term loans                    | \$ | 1,875 |
| Trade payables                      |    | 484   |
| Employees and payroll accruals      |    | 263   |
| Deferred revenues                   |    | 485   |
| Other payables and accrued expenses |    | 730   |
|                                     |    | 3,837 |

**Long-Term Liabilities**

|                       |  |     |
|-----------------------|--|-----|
| Accrued severance pay |  | 407 |
|-----------------------|--|-----|

**STOCKHOLDERS' DEFICIENCY**

|                                      |  |          |
|--------------------------------------|--|----------|
| Stock capital                        |  | 209      |
| Receipts on account of stock capital |  | 369      |
| Additional paid-in capital           |  | 11,347   |
| Accumulated deficit                  |  | (11,948) |
|                                      |  | (23)     |

|   |           |              |
|---|-----------|--------------|
| <b>Total liabilities and stockholders' deficiency</b> | <b>\$</b> | <b>4,221</b> |
|---|-----------|--------------|

The accompanying notes to these financial statements are an integral part thereof.

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**SPO MEDICAL INC.  
AND ITS SUBSIDIARY**  
**CONDENSED INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS**  
U.S. dollars in thousands except share data

|   | Nine months ended<br>September 30,<br>Unaudited |            | Three months ended<br>September 30,<br>Unaudited |            |
|---|---|------------|--|------------|
|   | 2007  | 2006       | 2007   | 2006       |
| <b>Revenues</b>   | \$ 4,174  | \$ 2,520   | \$ 1,408   | \$ 929     |
| Cost of revenues  | 1,938   | 1,264      | 673  | 435        |
| Gross profit  | 2,236   | 1,256      | 735  | 494        |
| Operating expenses  |   |            |  |            |
| Research and development  | 799   | 549        | 256  | 204        |
| Selling and marketing   | 552   | 463        | 162  | 161        |
| General and administrative  | 1,030   | 716        | 438  | 197        |
| Total operating expenses  | 2,381   | 1,728      | 856  | 562        |
| <b>Operating loss</b>   | 145   | 472        | 121  | 68         |
| Financial expenses, net   | 754   | 4,044      | 315  | 2,742      |
| <b>Loss for the period</b>  | \$ 899  | \$ 4,516   | \$ 436   | \$ 2,810   |
| Basic and diluted loss per ordinary share   | \$ (0.04)                                       | \$ (0.24)  | \$ (0.02)  | \$ (0.15)  |
| Weighted average number of shares outstanding used in computation of basic and diluted loss per share | 20,731,725                                      | 18,690,751 | 21,769,785                                       | 19,239,858 |

The accompanying notes to these financial statements are an integral part thereof.

**SPO MEDICAL INC.  
AND ITS SUBSIDIARY**  
**CONDENSED STATEMENTS OF CHANGES IN STOCKHOLDERS DEFICIENCY**  
**U.S. dollars in thousands**

|  | Stock<br>capital | Additional<br>paid-in<br>capital | Receipts<br>on<br>account<br>for stock<br>capital | Deferred<br>compensation | Accumulated<br>deficit | Total    |
|--|------------------|----------------------------------|---|--------------------------|------------------------|----------|
| <b>Balance as of January 1,<br/>2005</b>   | \$ 600           | \$ 2,675                         | \$ -  | \$ -                     | (4,048)                | \$ (773) |
| Issuance of ordinary shares<br>upon conversion of loans  | 35               | 224                              |   |                          |                        | 259      |
| Warrants issued in private<br>placements   |                  | 949                              |   |                          |                        | 949      |
| Warrants issued in connection<br>with loans  |                  | 22                               |   |                          |                        | 22       |
| Deferred stock-based<br>compensation related to<br>options granted to employees<br>and consultants   |                  | 762                              |   | (762)                    |                        | -        |
| Amortization of deferred<br>Stock-based compensation<br>related to options granted to<br>employees   |                  |                                  |   | 187                      |                        | 187      |
| Amortization of deferred<br>Stock-based compensation<br>related to options granted to<br>consultant  |                  |                                  |   | 348                      |                        | 348      |
| Reverse merger transaction<br>and forward split of issued<br>share capital                           | (465)            | 201                              |   |                          |                        | (264)    |
| Net Loss   |                  |                                  |   |                          | (2,038)                | (2,038)  |
| <b>Balance as of December 31,<br/>2005</b>   | 170              | 4,833                            | -   | (227)                    | (6,086)                | (1,310)  |
| Deferred compensation<br>reclassified due to FAS 123R<br>implementation for the first<br>time        |                  | (227)                            |   | 227                      |                        | -        |
| Warrants issued in connection<br>with loans  |                  | 530                              |   |                          |                        | 530      |
| Amortization of deferred<br>stock-based compensation<br>related to options granted to<br>consultants |                  | 893                              |   |                          |                        | 893      |
| Exercise of warrants by<br>external consultant   | 5                |                                  |   |                          |                        | 5        |
|  |                  | 2,534                            |   |                          |                        | 2,534    |

|   |    |     |    |       |    |         |             |          |
|---|----|-----|----|-------|----|---------|-------------|----------|
| Benefit resulting from changes to warrant terms   |    |     |    |       |    |         |             |          |
| Exercise of convertible notes   | 9  | 560 |    |       |    |         | 569         |          |
| amortization of deferred Stock-based compensation related to options granted to employees and directors |    | 260 |    |       |    |         | 260         |          |
| Issuance of stock capital   | 9  | 571 |    |       |    |         | 580         |          |
| Net Loss  |    |     |    |       |    | (4,963) | (4,963)     |          |
| <b>Balance as of December 31, 2006</b>  | \$ | 193 | \$ | 9,954 | \$ | -       | \$ (11,049) | \$ (902) |

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**SPO MEDICAL INC.  
AND ITS SUBSIDIARY  
CONDENSED STATEMENTS OF CHANGES IN STOCKHOLDERS DEFICIENCY  
U.S. dollars in thousands**

|  | Stock<br>capital | Additional<br>paid-in<br>capital | Receipts<br>on<br>account<br>for stock<br>capital | Deferred<br>compensation | Accumulated<br>deficit | Total |
|--|------------------|----------------------------------|---|--------------------------|------------------------|-------|
| <b>Balance as of December 31,<br/>2006</b>   | \$ 193           | \$ 9,954                         | -   | -                        | (11,049)               | (902) |
| Exercise of stock options  | 2                | 8                                |   |                          |                        | 10    |
| Issuance of stock capital, net   | 14               | 1,169                            |   |                          |                        | 1,183 |
| Warrants issued in connection<br>with credit line  |                  | 19                               |   |                          |                        | 19    |
| Receipts on account for stock<br>capital from conversion of<br>loan Notes  |                  |                                  | 257   |                          |                        | 257   |
| Benefit related to conversion<br>of loan Notes   |                  |                                  | 112   |                          |                        | 112   |
| Amortization of deferred<br>Stock-based compensation<br>related to options granted to<br>employees, consultants and<br>directors |                  | 197                              |   |                          |                        | 197   |
| Net Loss   |                  |                                  |   |                          | (899)                  | (899) |
| <b>Balance as of September 30,<br/>2007, (Unaudited)</b>   | \$ 209           | \$ 11,347                        | 369   | -                        | (11,948)               | (23)  |

The accompanying notes to these financial statements are an integral part thereof.

**SPO MEDICAL INC.  
AND ITS SUBSIDIARY  
CONDENSED INTERIM STATEMENTS OF CASH FLOWS  
U.S. dollars in thousands**

|   | Nine months ended<br>September 30, |            | Three months ended<br>September 30, |            |
|---|------------------------------------|------------|-------------------------------------|------------|
|   | 2007                               | 2006       | 2007                                | 2006       |
| <b>Cash Flows from Operating Activities</b>                             |                                    |            |                                     |            |
| Loss for the period   | \$ (899)                           | \$ (4,516) | \$ (436)                            | \$ (2,810) |
| Adjustments to reconcile loss to net cash used in operating activities: |                                    |            |                                     |            |
| Depreciation  | 21                                 | 17         | 8                                   | 5          |
| Stock-based compensation expenses                                       | 286                                | 952        | 147                                 | 50         |
| Amortization of loan discounts, net                                     | 440                                | 625        | 107                                 | 148        |
| Benefit resulting from changes to warrant terms                         | 42                                 | 2,534      | 42                                  | 2,534      |
| Increase (decrease) in accrued severance pay, net                       | 2                                  | (13)       | (5)                                 | (7)        |
| Increase in accrued interest payable on loans                           | 121                                | 114        | 38                                  | 45         |
| Changes in assets and liabilities:                                      |                                    |            |                                     |            |
| Increase in trade receivables   | (442)                              | (335)      | (260)                               | (83)       |
| Decrease (increase) in other receivables                                | 70                                 | (47)       | 115                                 | (41)       |
| Decrease (Increase) in inventories                                      | (182)                              | (202)      | 53                                  | (160)      |
| Increase (decrease) in trade payable                                    | (4)                                | 93         | (173)                               | 1          |
| Increase in other payables and accrued expenses                         | 297                                | 331        | 62                                  | 228        |
| Net cash used in operating activities                                   | (248)                              | (447)      | (302)                               | (90)       |
| <b>Cash Flows from Investing Activities</b>                             |                                    |            |                                     |            |
| Decrease (Increase) in deposits   | (1)                                | (1)        | 1                                   | -          |
| Sale of property and equipment  | 1                                  | -          | 1                                   | -          |
| Purchase of property and equipment                                      | (36)                               | (55)       | (12)                                | (21)       |
| Net cash used in investing activities                                   | (36)                               | (56)       | (10)                                | (21)       |
| <b>Cash Flows from Financing Activities</b>                             |                                    |            |                                     |            |
| Issuance of stock capital   | 1,183                              | 580        | 1,183                               | -          |
| Exercise of warrants by consultant                                      | -                                  | 5          | -                                   | -          |
| Receipt of short-term loan  | -                                  | 152        | -                                   | 68         |
| Proceeds on grant of exercisable warrants                               | -                                  | 428        | -                                   | 362        |
| Exercise of stock options   | 10                                 | -          | -                                   | -          |
| Repayment of short-term loans   | (122)                              | (301)      | (81)                                | (40)       |
| Net cash provided by financing activities                               | 1,071                              | 864        | 1,102                               | 390        |
| Increase in cash and cash equivalents                                   | 787                                | 361        | 790                                 | 279        |

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|   |          |        |          |        |
|---|----------|--------|----------|--------|
| Cash and cash equivalents at the beginning of the period            | 836      | 493    | 833      | 575    |
| Cash and cash equivalents at the end of the period                  | \$ 1,623 | \$ 854 | \$ 1,623 | \$ 854 |
| Non cash transactions:  |          |        |          |        |
| conversion of convertible notes                                     | \$ -     | \$ 569 | \$ -     | \$ 569 |
| Receipts on account for stock capital from conversion of loan Notes | \$ 257   | \$ -   | \$ 257   | \$ -   |

The accompanying notes to these financial statements are an integral part thereof.

**SPO MEDICAL INC.  
AND ITS SUBSIDIARY  
NOTES TO FINANCIAL STATEMENT  
U.S. dollars in thousands except share data**

**NOTE 1 - General**

SPO Medical Inc. (hereinafter referred to as "SPO" or the "Company") was originally incorporated under the laws of the State of Delaware in September 1981 under the name "Applied DNA Systems, Inc." On November 16, 1994, the Company changed its name to "Nu-Tech Bio-Med, Inc." On December 23, 1998, the Company changed its name to "United Diagnostic, Inc." Effective April 21, 2005, the Company acquired (the "Acquisition Transaction") 100% of the outstanding capital stock of SPO Medical Equipment Ltd., a company incorporated under the laws of the State of Israel ("SPO Ltd."), pursuant to a Capital Stock Exchange Agreement dated as of February 28, 2005 between the Company, SPO Ltd. and the shareholders of SPO Ltd., as amended and restated on April 21, 2005 (the "Exchange Agreement"). In exchange for the outstanding capital stock of SPO Ltd., the Company issued to the former shareholders of SPO Ltd. a total of 5,769,106 shares of the Company's common stock, par value \$0.01 per share ("Common Stock"), representing approximately 90% of the Common Stock then issued and outstanding after giving effect to the Acquisition Transaction. As a result of the Acquisition Transaction, SPO Ltd. became a wholly owned subsidiary of the Company as of April 21, 2005 and, subsequent to the Acquisition Transaction, the Company changed its name to "SPO Medical Inc." Upon consummation of the Acquisition Transaction, the Company effectuated a forward subdivision of the Company's Common Stock issued and outstanding on a 2.65285:1 basis.

The merger between UNDI and the SPO Ltd was accounted for as a reverse merger. As the shareholders of SPO Ltd received the largest ownership interest in the Company, SPO Ltd was determined to be the "accounting acquirer" in the reverse acquisition. As a result, the historical financial statements of the Company were replaced with the historical financial statements of SPO Ltd.

The Company and its subsidiary, SPO Ltd., are collectively referred to as the "Company".

**NOTE 2 - Basis of Presentation**

The accompanying un-audited condensed consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-QSB and Article 10 of Regulation S-X. These financial statements reflect all adjustments, consisting of normal recurring adjustments and accruals, which are, in the opinion of management, necessary for a fair presentation of the financial position of the Company as of September 30, 2007 and the results of operations and cash flows for the interim periods indicated in conformity with generally accepted accounting principles applicable to interim periods. Accordingly, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted.

The nine and three months ended September 30, 2007, are not necessarily indicative of the results that may be expected for the year ended December 31, 2007.

**SPO MEDICAL INC.  
AND ITS SUBSIDIARY  
NOTES TO FINANCIAL STATEMENT  
U.S. dollars in thousands except share data**

**NOTE 3 - GOING CONCERN**

As reflected in the accompanying financial statements, the Company's operations for the nine and three months ended September 30, 2007, resulted in a net loss of \$899 and \$436 respectively, and the Company's balance sheet reflects a net stockholders' deficit of \$23. The Company's ability to continue operating as a "going concern" is dependent on its ability to raise additional working capital. Management's plans in this regard include raising additional cash from current and potential stockholders and increasing the marketing of its current and new products.

**NOTE 4 - STOCKHOLDERS EQUITY**

On July 5, 2007, the Company privately placed with an institutional investor 1,444,444 shares of its Common Stock for aggregate gross proceeds of \$1,300. The Shares were placed pursuant to a Confidential Private Placement Agreement between the Company and the investor entered into as of July 5, 2007. In connection with the placement of the shares, the Company paid to a placement agent a cash fee of \$117.

In July 2006, the Company commenced a private placement of units of securities, with each unit comprised of (i) the Company's 8% month promissory note due 12 months from the date of issuance and (ii) warrants as described below, pursuant to which it raised \$550 (the maximum amount that could be raised from this offering). Under the terms of the offering, the principal and accrued interest is due in one balloon payment at the end of the twelve month period. Each purchaser of the notes received warrants, exercisable over a period of two years from the date of issuance, to purchase 16,250 shares of Common Stock for each \$25 of principal loaned, at a per share exercise price equal to the lower of \$1.50 or 35% less than any the offering price at an initial public offering of the Company's Common Stock during the warrant exercise period. During the quarter ended September 30, 2007, the Company offered to the holders of the notes to convert the principal and accrued interest into shares of the Company's Common Stock at a per share conversion price of \$0.90 and to reduce the per share exercise price of the warrants to \$0.90. As of November XX, 2007, the holders of \$238 of the principal amount agreed to convert the principal and accrued interest thereon into shares of the Company's Common Stock. The Company repaid to a note holder the principal amount of \$75 and the accrued interest thereon. The warrants held by note holders who do not convert are not being repriced.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION**

THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH OUR FINANCIAL STATEMENTS AND THE NOTES RELATED TO THOSE STATEMENTS. SOME OF OUR DISCUSSION IS FORWARD-LOOKING AND INVOLVES RISKS AND UNCERTAINTIES. FOR INFORMATION REGARDING RISK FACTORS THAT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, REFER TO THE RISK FACTORS SECTION OF THE ANNUAL REPORT ON FORM 10-KSB FOR THE YEAR ENDED DECEMBER 31, 2006.

### **OVERVIEW**

SPO Medical Inc. is engaged in the design, development and marketing of non-invasive pulse oximetry technologies to monitor blood oxygen saturation and heart rate for a variety of markets, including medical, homecare, sports and search & rescue. Pulse oximetry is a non-invasive process used to measure blood oxygen saturation levels and is an established procedure in medical practice. We utilize proprietary and patented technologies to deliver oximetry functionality through innovative commercial products that address such applications as emergency care, home monitoring, sleep apnea, cardiovascular performance, cardiac rehabilitation and the physiological monitoring of military personnel and safety care workers.

We have developed and patented proprietary technology that enables the use of pulse oximetry in a reflectance mode of operation (i.e. a sensor that can be affixed to a single side of a body part). This technique is known as Reflectance Pulse Oximetry (RPO). Using RPO, a sensor can be positioned on various body parts, hence minimizing problems of motion and poor perfusion. The unique design features contribute to substantially lower electric power requirements and enable a wireless, stand-alone configuration with expanded commercial possibilities. We hold three patents issued by the United States Patent and Trademark Office ("USPTO") covering various aspects of our unique sensors for radiance based diagnostics using pulse oximetry. Although we believe that our existing issued patents provide a competitive advantage, there can be no assurance that the scope of our patent protection is or will be adequate to protect our technologies or that the validity of any patent issued will be upheld in the future.

We were originally organized under the laws of the State of Delaware in September 1981 under the name "Applied DNA Systems, Inc." On November 16, 1994, we changed our name to "Nu-Tech Bio-Med, Inc." On December 23, 1998, we changed our name to "United Diagnostic, Inc." Effective April 21, 2005, we acquired 100% of the outstanding capital stock of SPO Ltd. pursuant to a Capital Stock Exchange Agreement dated as of February 28, 2005 among the Company, SPO Ltd. and the shareholders of SPO Ltd., as amended and restated on April 21, 2005 pursuant to which we issued to the former shareholders of SPO Ltd. a total of 5,769,106 shares of the Company's Common Stock representing approximately 90% of the Common Stock then issued and outstanding.

As of November \_\_, 2007, we had 19 employees (and consultants) working on a full time basis. On October 8, 2007, our common stock began to be quoted on the over-the-counter- Bulletin Board under the stock symbol "SPOM".

### **CRITICAL ACCOUNTING POLICIES**

The discussion and analysis of our financial condition and results of operations are based upon our unaudited consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, bad debts, investments, intangible assets and income taxes. Our estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

We have identified the accounting policies below as critical to our business operations and the understanding of our results of operations.

**REVENUE RECOGNITION**

We generate revenues principally from sales of our products. Revenues from the sale of products are recognized when delivery has occurred, persuasive evidence of an arrangement exists, the vendor's fee is fixed or determinable, no further obligation exists and collection of is probable and there are no remaining significant obligations. Delivery is deemed to have occurred upon shipment of products from any of our distribution centers.

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## **INVENTORY VALUATION**

Inventories are stated at the lower of cost or market value. Cost is determined as follows: Raw materials, components and finished products are valued using the first in first out (FIFO) basis. Work-in-process - is valued on the basis of cost or market value of the raw materials components plus the related manufacturing costs.

## **USE OF ESTIMATES**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

## **RESULTS OF OPERATIONS**

### **COMPARISON OF THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2007 AND THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006**

**REVENUES .** Revenues are currently derived primarily from sales of our PulseOX 5500 TM and Check Mate products designed for the medical, homecare and sports markets. Revenues for the three and nine months ended September 30, 2007 were \$1,408,000 and \$4,174,000, respectively. Revenues for the corresponding periods in 2006 were \$929,000 and \$2,520,000, respectively. The increase in revenues during the 2007 periods reflected increased sales of our products.

**COSTS OF REVENUES.** Costs of revenues for the three and nine months ended September 30, 2007 were \$673,000 and \$1,938,000, respectively. Costs of revenues for the corresponding periods in 2006 were \$435,000 and \$1,264,000, respectively. Costs of revenues include all costs related to manufacturing and selling products and services and consist primarily of direct material costs and salaries and related expenses for personnel. The increase in cost of revenues during the 2007 periods is primarily attributable to the increase in sales of our products.

**RESEARCH AND DEVELOPMENT EXPENSES.** Research and development expenses consist primarily of expenses incurred in the design, development and testing of our products. These expenses consist primarily of salaries and related expenses for personnel, contract design and testing services, supplies used and consulting and license fees paid to third parties. Research and development expenses for the three and nine months ended September 30, 2007 were \$256,000 and \$799,000, respectively. Research and development expenses for the corresponding periods in 2006 were \$204,000 and \$549,000, respectively. The increase in research and development expenses during the 2007 periods is primarily attributable to increased employee and related compensation costs and in the investment of developing new products.

**SELLING AND MARKETING EXPENSES.** Selling and marketing expenses consist primarily of costs relating to compensation attributable to employees engaged in sales and marketing activities, promotion, sales support, travel and related expenses. Selling and marketing expenses for the three and nine months ended September 30, 2007 were \$162,000 and \$552,000, respectively. Selling and marketing expenses for the corresponding periods in 2006 were \$161,000 and \$463,000, respectively. The increase in selling and marketing expenses during 2007 is primarily attributable to the amounts expensed that related to market research for new products being developed.

**GENERAL AND ADMINISTRATIVE EXPENSES.** General and administrative expenses primarily consist of salaries and other related costs for personnel in executive and other administrative functions. Other significant costs include professional fees for legal, accounting services. General and administrative expenses for the three and nine months ended September 30, 2007 were \$438,000 and \$1,030,000, respectively. General and administrative costs for the corresponding periods in 2006 were \$197,000 and \$716,000 respectively. The increase in general and



administrative expenses during 2007 is primarily attributable to professional fees incurred in connection with our efforts to raise additional funds through public and/or private offerings of our securities in and outside the United States.

FINANCIAL EXPENSES, NET . Financial expense, net, for the three and nine months ended September 30, 2007 were \$315,000 and \$754,000, respectively. Financial expenses, net, for the corresponding periods in 2006 were \$2,742,000 and \$4,044,000 respectively. The decrease in financial expenses is primarily attributable to a one time non-cash expense that was recognized in the 2006 periods in respect of stock based compensation benefits as well the interest accrued on loans that were advanced to us since April 2005 and which matured during 2006.

NET LOSS. For the three and nine months ended September 30, 2007 we had a net loss of \$436,000 and \$899,000, respectively. Net loss for the corresponding periods in 2006 were \$2,810,000 and \$4,516,000, respectively. The decrease in net loss during the 2007 periods is primarily attributable to the one time non-cash expense that was recognized in the 2006 periods in respect of deferred compensation benefits and interest expenses on loans which are discussed above under "Financial Expenses, Net".

## LIQUIDITY AND CAPITAL RESOURCES

As at September 30, 2007, we had cash and cash equivalents of approximately \$1,623,000 compared to \$836,000 at December 31, 2006. Our cash position improved as a result of the proceeds from the private placement that we completed in July 2007 which is discussed further, below.

We generated net negative cash flows from operating activities of approximately \$248,000 during the nine months ended September 30, 2007 compared to negative cash flows of approximately \$447,000 for the nine months ended September 30, 2006.

In December 2005 we completed the private placement to certain accredited investors that we commenced in April 2005 for the issuance of up to \$1,544,000 of units of our securities, with each unit comprised of (i) our 18 month 6% promissory note (collectively, the "April 2005 Notes") and (ii) three year warrants to purchase up to such number of shares of our Common Stock as are determined by the principal amount of the Note purchased by such investor divided by \$ 0.85 (collectively the "April 2005 Warrants"). In September 2006, we offered to the holders of the April 2005 Notes to revise certain of the terms of the original offering in order to facilitate an extension to the scheduled maturity date of the Note, (hereinafter the "Amendment"). The Amendment provides that (a) the maturity date of the April 2005 Notes is to be extended to March 26, 2008, (b) the exercise period of the April 2005 Warrants is to be extended from three to five years with an expiration date of September 26, 2010 and the per share exercise price was adjusted to \$0.60 and (c) the interest rate on the amounts outstanding under the April 2005 Notes was increased to 8% per annum, effective July 12, 2006. The Amendment also provides that if we subsequently issue shares of our Common Stock at an effective per share exercise price less than that of the adjusted per share exercise price of the April 2005 Warrants during the adjusted exercise period, then the exercise price thereof is to be reduced to such lower exercise price; provided, that, this protection will not apply to certain of our equity or debt issuances (i) from approved stock option plans to employees, directors and other service providers, (ii) upon exercise of options and warrants outstanding as of September 27, 2006 and (iii) to our consultants that an unaffiliated third party would deem to be commercially reasonable and fair. In addition, the Amendment also provides that, subject to certain qualifications, our obligation to file a registration statement under the Securities Act of 1933, as amended, relating to the resale of our Common Stock underlying the April 2005 Warrants is extended to April 15, 2007. The Amendment became effective as of September 30, 2006. The Amendment resulted in a one time non-cash finance expense in the amount of approximately \$2,500,000 being recognized in 2006. As of November 5, 2007, holders of Notes in the principal amount \$1,439,000 have signed the Amendment and the holder of a note in the principal amount of \$50,000 which matured on November 30, 2006 has requested repayment of principle and accrued interest. The Company is currently in contact with the remaining note holders of \$55,000 of the April 2005 Notes with respect to obtaining their formal execution of the Amendment.

In July 2006, we commenced a private placement of units of our securities, with each unit comprised of (i) our 8% month promissory note due 12 months from the date of issuance and (ii) warrants as described below, pursuant to which we raised \$550,000 (the maximum amount that could be raised from this offering). Under the terms of the offering, the principal and accrued interest is due in one balloon payment at the end of the twelve month period. Each purchaser of the notes received warrants, exercisable over a period of two years from the date of issuance, to purchase 16,250 shares of Common Stock for each \$25,000 of principal loaned, at a per share exercise price equal to the lower of \$1.50 or 35% less than any the offering price at an initial public offering of the Company's Common Stock during the warrant exercise period. During the quarter ended September 30, 2007, we offered to the holders of

the notes to convert the principal and accrued interest into shares of the Company's Common Stock at a per share conversion price of \$0.90. As of November 5, 2007 the holders of \$238,000 of the principal amount agreed to convert the principal and accrued interest thereon into shares of our Common Stock. We repaid to a note holder the principal amount of \$75,000 and the accrued interest thereon. The Company is currently in contact with the remaining note holders with respect to obtaining their consent to the Amendment and the conversion of their Notes.

Our recent financings are discussed below.

In March 2007, we entered into a Line of Credit Facility with an institutional investor pursuant to which we can borrow up to \$200,000, which can be drawn on demand at the discretion of the Company. The facility continues in effect until January 28, 2008. Amounts outstanding accrue interest at a per annum rate of 9% and accrued interest is payable on a quarterly basis. All amounts borrowed and accrued and unpaid interest need to be repaid by January 28, 2009. In consideration of the line of credit facility, we issued to the investor a warrant for 50,000 shares of our Common Stock, exercisable through March 27, 2010 at a per share exercise price of \$1.50, of which warrants for 20,000 shares is exercisable immediately and the warrants for the remaining 30,000 shares exercisable only following (and subject to) our first draw-down under the facility. To date, we have not drawn down any amounts under the line of credit facility.

In July 2007 we issued to an investor 1,444,444 shares of our Common Stock for aggregate gross proceeds of \$1,300,000. The net proceeds from this financing were \$1,183,000 after cash fee paid to the placement agent.

We will need to raise additional funds to be able to satisfy our cash requirements over the next twelve months. Continuing product development and enhancement, expected new product launches, corporate operations and marketing expenses will continue to require additional capital. Our current revenues from operations are insufficient to cover our projected expansion plans. We therefore are seeking additional financing through the sale of our equity and/or debt securities to satisfy future capital requirements until such time as we are able to generate sufficient cash flow from revenues to finance on-going operations. No assurance can be provided that additional capital will be available to us on commercially acceptable or at all. Our auditors included a "going concern" qualification in their auditors' report for the year ended December 31, 2006. While we raised approximately \$1,300,000 in gross proceeds from the issuance of our debt and equity securities during 2006, such "going concern" qualification may make it more difficult for us to raise funds when needed. Additional equity financings may be dilutive to holders of our Common Stock.

### **ITEM 3. CONTROLS AND PROCEDURES**

**EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES.** We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, 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 based closely on the definition of "disclosure controls and procedures" in Rule 13a-14(c).

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

**CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING.** During the quarter ended September 30, 2007, there have been no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, these controls.

## **PART II - OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS.**

None.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

The following paragraph sets forth certain information with respect to all securities sold by us during the three months ended September 30, 2007 without registration under the Securities Act.

1. On July 5, 2007, we issued to an investor 1,444,444 shares of our Common Stock for total gross cash proceeds of \$1,300,000.
2. On September 4, 2007, we issued to a service provider warrants, exercisable through September 2011, to purchase up to 100,000 shares of our Common Stock, exercisable upon certain specified events.



All of the securities issued in the transactions described above were issued without registration under the Securities Act in reliance upon the exemptions provided in Section 4(2) of the Securities Act or Regulation S under such Securities Act. Except with respect to securities sold under Regulation S, the recipients of securities in each such transaction acquired the securities for investment only and not with a view to or for sale in connection with any distribution thereof. Appropriate legends were affixed to the share certificates issued in all of the above transactions. Each of the recipients represented that they were “accredited investors” within the meaning of Rule 501(a) of Regulation D under the Securities Act, or had such knowledge and experience in financial and business matters as to be able to evaluate the merits and risks of an investment in its common stock. All recipients had adequate access, through their relationships with the Company and its officers and directors, to information about the Company. None of the transactions described above involved general solicitation or advertising.

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

None.

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

None.

**ITEM 5. OTHER INFORMATION.**

None.

**ITEM 6. EXHIBITS.**

- 10.1 Confidential Private Placement Subscription Agreement dated as of July 7, 2007 by and between SPO Medical Inc. and Rig III.
- 10.2 Form of Agreement Relating to the Conversion of outstanding Debt Instruments
- 31.1 Rule 13a - 14(a) Certification of Principal Executive Officer
- 31.2 Rule 13a - 14(a) Certification of Principal Financial Officer
- 32.1 Section 1350 Certification of Principal Executive Officer
- 32.2 Section 1350 Certification of Principal Financial Officer

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**SIGNATURES**

In accordance with the requirements of the Exchange Act, the small business issuer has caused this report to be signed by the undersigned thereunto duly authorized.

DATE: November 5, 2007

SPO MEDICAL INC.

/s/ MICHAEL BRAUNOLD  
MICHAEL BRAUNOLD  
PRESIDENT AND CHIEF EXECUTIVE OFFICER

**PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER**

DATE: November 5, 2007

BY /s/ JEFF FEUER  
JEFF FEUER,  
CHIEF FINANCIAL OFFICER  
(PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER)