

Edgar Filing: SPO Medical Inc - Form 10QSB

SPO Medical Inc  
Form 10QSB  
September 19, 2006

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 June 30, 2006; 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 25-1411971  
(State or other jurisdiction of (I.R.S. Employer Identification No.)  
incorporation or organization)

21860 BURBANK BLVD., NORTH BUILDING, SUITE 380  
Woodland Hills, CA 91367  
(Address of principal executive offices, including zip code)

818-888-4380  
(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 1b-2 of the Exchange Act). Yes  No .

As of September 15, 2006, SPO Medical Inc. had outstanding 18,386,576 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.

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SPO MEDICAL INC.  
AND ITS SUBSIDIARY  
CONDENSED INTERIM CONSOLIDATED BALANCE SHEET

-----  
U.S. DOLLARS IN THOUSANDS

JUNE 30, 2006  
UNAUDITED  
-----

ASSETS

CURRENT ASSETS

|  |    |     |
|--|----|-----|
| Cash and cash equivalents                      | \$ | 575 |
| Trade receivables                              |    | 451 |
| Other accounts receivable and prepaid expenses |    | 48  |
| Inventories                                    |    | 502 |

-----  
\$ 1,576

LONG-TERM INVESTMENTS

|                    |  |     |
|--------------------|--|-----|
| Deposits           |  | 11  |
| Severance pay fund |  | 167 |

-----  
178

PROPERTY AND EQUIPMENT, NET

70

TOTAL ASSETS

\$ 1,824  
=====

LIABILITIES AND STOCKHOLDERS' DEFICIENCY

CURRENT LIABILITIES

|                                     |    |       |
|-------------------------------------|----|-------|
| Short-term loans                    | \$ | 1,165 |
| Short-term convertible loans        |    | 722   |
| Trade payables                      |    | 317   |
| Employees and payroll accruals      |    | 191   |
| Other payables and accrued expenses |    | 601   |

-----  
2,996

LONG-TERM LIABILITIES

|                       |  |     |
|-----------------------|--|-----|
| Accrued severance pay |  | 290 |
|-----------------------|--|-----|

STOCKHOLDERS' DEFICIENCY

|                            |  |         |
|----------------------------|--|---------|
| Stock capital              |  | 184     |
| Additional paid-in capital |  | 6,146   |
| Accumulated deficit        |  | (7,792) |

-----  
(1,462)

TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIENCY

\$ 1,824  
=====

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

|   | SIX MONTHS ENDED<br>JUNE 30, |            | THREE M<br>J |
|---|------------------------------|------------|--------------|
|   | 2006                         | 2005       | 2006         |
| REVENUES  | \$ 1,591                     | \$ 742     | \$ 890       |
| Cost of revenues  | 829                          | 335        | 459          |
| Gross profit  | 762                          | 407        | 431          |
| Operating expenses  |                              |            |              |
| Research and development, net   | 345                          | 259        | 193          |
| Selling and marketing   | 302                          | 236        | 161          |
| General and administrative  | 519                          | 334        | 299          |
| Merger expenses   | --                           | 251        | --           |
| Total operating expenses  | 1,166                        | 1,080      | 653          |
| OPERATING LOSS  | 404                          | 673        | 222          |
| Financial expenses, net   | 1,302                        | 99         | 363          |
| LOSS FOR THE PERIOD   | \$ 1,706                     | \$ 772     | \$ 585       |
| Basic and diluted loss per ordinary share   | \$ (0.09)                    | \$ (0.04)  | \$ (0.03)    |
| Weighted average number of shares<br>outstanding used in computation of basic and<br>diluted loss per share | 18,410,096                   | 17,475,790 | 18,487,477   |

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

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U.S. DOLLARS IN THOUSANDS

|   | SHARE<br>CAPITAL | ADDITIONAL<br>PAID-IN<br>CAPITAL | DEFERRED<br>COMPENSATION | ACCUM<br>DEF |
|---|------------------|----------------------------------|--------------------------|--------------|
|   | -----            | -----                            | -----                    | -----        |
| BALANCE AS OF JANUARY 1, 2004   | \$ 501           | \$ 927                           | \$ --                    | \$ (1        |
| Issuance of ordinary shares to consultants  | 99               | 1,272                            | --                       |              |
| Stock-based compensation related to<br>options granted to employee                                | --               | 283                              | --                       |              |
| Stock-based compensation related to<br>warrant granted to lender                                  | --               | 78                               | --                       |              |
| Beneficial conversion feature of<br>convertible notes   | --               | 115                              | --                       |              |
| Net Loss  | --               | --                               | --                       | (2           |
|   | -----            | -----                            | -----                    | -----        |
| BALANCE AS OF DECEMBER 31, 2004   | 600              | 2,675                            | --                       | (4           |
| Issuance of ordinary shares upon<br>conversion of loans   | 35               | 224                              | --                       |              |
| Warrants issued in private placements   | --               | 949                              | --                       |              |
| Warrants issued in connection with loans  | --               | 22                               | --                       |              |
| Deferred stock-based compensation related<br>to options granted to employees and<br>consultants   | --               | 762                              | (762)                    |              |
| Amortization of deferred Stock-based<br>compensation related to options granted<br>to employees   | --               | --                               | 187                      |              |
| Amortization of deferred Stock-based<br>compensation related to options granted to<br>consultant  | --               | --                               | 348                      |              |
| Reverse merger transaction and forward<br>split of issued share capital                           | (465)            | 201                              | --                       |              |
| Net Loss  | --               | --                               | --                       | (2           |
|   | -----            | -----                            | -----                    | -----        |
| BALANCE AS OF DECEMBER 31, 2005   | 170              | 4,833                            | (227)                    | (6           |
| Deferred compensation reclassified due to<br>FAS 123R implementation for the first time           | --               | (227)                            | 227                      |              |
| Warrants issued in connection with loan   | --               | 66                               | --                       |              |
| Amortization of deferred stock-based<br>compensation related to options granted to<br>consultants | --               | 749                              | --                       |              |
| Exercise of warrants by consultant  | 5                | --                               | --                       |              |
| Amortization of deferred Stock-based<br>compensation related to options granted to<br>employees   | --               | 83                               | --                       |              |
| Amortization of deferred Stock-based<br>compensation related to options granted to<br>directors   | --               | 71                               | --                       |              |
| Issuance of ordinary shares   | 9                | 571                              | --                       |              |
| Net Loss  | --               | --                               | --                       | (1           |
|   | -----            | -----                            | -----                    | -----        |
| BALANCE AS OF JUNE 30, 2006   | \$ 184           | \$ 6,146                         | \$ --                    | \$ (7        |
|   | -----            | -----                            | -----                    | -----        |

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

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SPO MEDICAL INC.  
AND ITS SUBSIDIARY  
CONDENSED INTERIM STATEMENTS OF CASH FLOWS

U.S. DOLLARS IN THOUSANDS

|   | SIX MONTHS ENDED<br>JUNE 30, |          | THREE    |
|---|------------------------------|----------|----------|
|   | 2006                         | 2005     | 2006     |
| CASH FLOWS FROM OPERATING ACTIVITIES                                    |                              |          |          |
| Loss for the period   | \$ (1,706)                   | \$ (772) | \$ (585) |
| Adjustments to reconcile loss to net cash used in operating activities: |                              |          |          |
| Depreciation  | 12                           | 3        | 5        |
| Stock-based compensation expenses                                       | 902                          | 82       | 117      |
| Amortization of loan discounts  | 477                          | 312      |          |
| Increase (decrease) in accrued severance pay, net                       | (6)                          | 97       | (2)      |
| Increase in accrued interest payable on loans                           | 69                           | 35       | 34       |
| Changes in assets and liabilities:                                      |                              |          |          |
| Increase in trade receivables   | (252)                        | (61)     | (133)    |
| Decrease (increase) in other receivables                                | (6)                          | (11)     | 4        |
| Decrease (Increase) in inventories                                      | (42)                         | (255)    | 50       |
| Increase (decrease) in accounts payable                                 | 92                           | 50       | (32)     |
| Decrease in other payables and accrued expenses                         | 103                          | 129      | 143      |
| Net cash used in operating activities                                   | (357)                        | (703)    | (87)     |
| CASH FLOWS FROM INVESTING ACTIVITIES                                    |                              |          |          |
| Decrease (Increase) in short-term investments                           | (1)                          | 33       | --       |
| Purchase of property and equipment                                      | (34)                         | (23)     | --       |
| Net cash used in investing activities                                   | (35)                         | 10       | --       |
| CASH FLOWS FROM FINANCING ACTIVITIES                                    |                              |          |          |
| Issuance of stock capital   | 580                          | --       | 95       |
| Exercise of warrants by consultant                                      | 5                            | --       | --       |
| Receipt of short-term loan  | 84                           | --       | --       |
| Proceeds on grant of exercisable warrants                               | 66                           | --       | --       |
| Receipt of long-term loan   | --                           | 815      | --       |
| Repayment of short-term loans   | (261)                        | (25)     | (39)     |
| Net cash provided by financing activities                               | 474                          | 790      | 56       |
| Increase (decrease) in cash and cash equivalents                        | 82                           | 97       | (31)     |
| Cash and cash equivalents at the beginning of the period                | 493                          | 9        | 606      |
| Cash and cash equivalents at the end of the period                      | \$ 575                       | \$ 106   | \$ 575   |

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

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### NOTE 1 - BASIS OF PRESENTATION

SPO Medical Inc. (hereinafter referred to as "SPO" or the "Company") was originally organized 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 among 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 accompanying financial statements included in this report for the periods prior to the Acquisition Transaction are the financial statements of SPO Ltd. The Company and its subsidiary, SPO Ltd., are collectively referred to as the "Company".

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 June 30, 2006 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. Operating results for the three and six months ended June 30, 2006, are not necessarily indicative of the results that may be expected for the year ended December 31, 2006.

Certain prior years' amounts have been reclassified in conformity with current year's financial statements.

### NOTE 2 -GOING CONCERN

As reflected in the accompanying financial statements, the Company's operations for the six and three months ended June 30, 2006, resulted in a net loss of \$1,706 and \$585 respectively, and the Company's balance sheet reflects a net stockholders' deficit of \$1,462. The Company's ability to continue operating as a "going concern" is dependent on its ability to raise sufficient additional

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working capital. Management's plans in this regard include raising additional cash from current and potential stockholders and lenders and increasing the marketing of its current and new products.

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### NOTE 3 - STOCK-BASED COMPENSATION

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment." SFAS No. 123(R) which requires the Company to measure all employee stock-based compensation awards using a fair value method and record such expense in its consolidated financial statements. In March 2005, the SEC issued Staff Accounting Bulletin (SAB) 107, which provides the Staff's views regarding interactions between SFAS No. 123(R) and certain SEC rules and regulations and provides interpretations of the valuation of share-based payments for public companies. The adoption of SFAS No. 123(R) requires additional accounting related to the income tax effects and additional disclosure regarding the cash flow effects resulting from share-based payment arrangements. The adoption of SFAS No. 123(R) in the six and three months ended June 30, 2006, had a material impact on the Company's consolidated results of operations, financial position and statement of cash flows.

SPO adopted the provisions of SFAS No. 123(R), "Share-Based Payment". SFAS No. 123(R) establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation cost is measured at grant date, based on the fair value of the award, and is recognized as expense over the employee requisite service period. The Company previously applied Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations and provided the required pro forma disclosures of SFAS No. 123, "Accounting for Stock-Based Compensation". Prior to the adoption of SFAS No. 123(R), the Company provided the disclosures required under SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosures."

The pro-forma information for the six months and three months ended June 30, 2005 is as follows:

|  | SIX MONTHS<br>ENDED<br>JUNE 30,<br>-----<br>2005<br>-----<br>UNAUDITED<br>----- | THREE MONTHS<br>ENDED<br>JUNE 30,<br>-----<br>2005<br>-----<br>UNAUDITED<br>----- |
|--|---|---|
| Net loss, as reported  | \$ 772  | \$ 581  |
| Deduct: Total stock-based compensation<br>expense determined under fair value<br>method for all awards | 31<br>-----   | 31<br>-----   |
| Pro forma net loss   | \$ 803<br>=====   | \$ 612<br>=====   |
| Basic and diluted net loss per share, as<br>reported   | \$ 0.04<br>=====  | \$ 0.03<br>=====  |
| Basic and diluted net loss per share, pro forma  | \$ 0.05   | \$ 0.03   |



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### NOTE 4:- NOTE

On February 1, 2006 the Company borrowed the principal amount of \$150. This loan bears interest at an annual rate of prime plus 4% and is repayable in four equal installments every three calendar months (commencing June 30, 2006) through January 31, 2007. The Company issued to the holder of this indebtedness a three-year warrant to purchase up to 60,000 shares of Common Stock at a per share exercise price of \$0.85. As of June 30, 2006, the Company repaid \$39 representing principal and accrued interest then due.

### NOTE 5: REPAYMENT OF OUTSTANDING DEBT

On September 6, 2005 the Company borrowed the principal amount of \$100. The principal amount of this loan, plus \$10 in respect of the arrangement fees was repaid on January 16, 2006. The Company issued to the holder of this indebtedness a three-year warrant to purchase up to 25,000 shares of Common Stock at a per share exercise price of \$0.75.

In August 2004 the Company negotiated with a lender the extension of the scheduled maturity date of indebtedness in the principal amount of \$140 that was originally scheduled to mature on October 12, 2005. The maturity date of \$100 of the original principal amount of this indebtedness was extended to March 31, 2006 and, on December 22, 2005, \$47 of the remaining principal amount and accrued interest was repaid. In consideration of the extension of the principal amount of \$100, the Company paid to the lender a one time arrangement fee of \$20 and issued to the holder of the debt a three-year warrant to purchase up to 15,000 shares of the Company's Common Stock at a per share price of \$0.75. On March 31, 2006 the principal amount of \$100 was repaid in full.

### NOTE 6: PRIVATE PLACEMENT

In January 2006, the Company entered into an agreement with an institutional investor for the private placement of 857,143 shares of its Common Stock for gross proceeds of \$600 (prior to the payment of placement related expenses aggregating approximately to \$20). The private placement was completed in June and the Common Stock has been issued is fully paid.

### NOTE 7: SUBSEQUENT EVENT

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. The principal and accrued interest are due in one balloon payment at the end of the twelve month period. Each purchaser of the note would receive 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. The maximum amount that can be raised under the offering is \$550. As of the date of the filing of this quarterly report on Form 10-QSB, the Company has raised \$385 in gross proceeds from this offering.

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

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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, 2005.

### 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 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.

### 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 from sales of our products. Revenues 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.

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Delivery is considered to have occurred upon delivery of products to the reseller.

### INVENTORY VALUATION

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

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### 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 SIX MONTHS ENDED JUNE 30, 2006 AND THE THREE AND SIX MONTHS ENDED JUNE 30, 2005 REVENUES.

Revenues are currently derived primarily from sales of our PulseOX 5500 TM and Check Mate TM designed for the medical, homecare and sports markets. Revenues for the three and six months ended June 30, 2006 were \$890 and \$1,591, respectively. Revenues for the corresponding periods in 2005 were \$368 and \$742, respectively. The increase in revenues during the 2006 periods reflected increased sales of our products.

Under our current marketing strategy we rely on a limited number of resellers in the United States, Europe and Asia to distribute our products. One of these resellers accounted for a significant part of the revenues that we have recorded to date. The loss of, or the significant decrease in purchases by this reseller could have a material adverse effect on our results of operation.

COSTS OF REVENUES. Costs of revenues for the three and six months ended June 30, 2006 were \$459 and \$829, respectively. Cost of revenues for the corresponding periods in 2005 were \$166 and \$335, respectively. Cost 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 and royalties paid and accrued to third parties or government agencies. This increase in cost of revenues during the 2006 periods is primarily attributable to the increase in sales of our products and costs associated with additional quality control processes on the introduction of new components into the 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 and regulatory services, supplies used and consulting and license fees and are net of any government grants and development fees charged to third parties. Research and development expenses for the three and six months ended June 30, 2006 were \$193 and \$345, respectively. Research and development expenses for the corresponding periods in 2005 were \$177 and \$259, respectively. The increase in research and development expenses during the 2006 periods as compared to the 2005 periods is also attributable to increased salary expenses and non cash expenses that we recorded as a result of the implementation of FAS123R as well as expenses incurred in connection with

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our continuing product enhancement efforts as well development costs associated with new product development.

**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 six months ended June 30, 2006 were \$161 and \$302, respectively. Selling and marketing expenses for the corresponding periods in 2005 were \$124 and \$236, respectively. The increase in selling and marketing expenses during the 2006 periods is also attributable to non cash expenses that we recorded as a result of the implementation of FAS123R as well as increases in compensation costs.

**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 six months ended June 30, 2006 were \$299 and \$519 respectively. General and administrative expenses for the corresponding periods in 2005 were \$228 and \$334, respectively. The increase in general and administrative expenses during the 2006 periods as compared to the 2005 period is primarily attributable to higher compensation costs that we incurred in connection with the hiring of new employees during 2005 and 2006 and other increased compensation costs and non cash expenses that we recorded as a result of the implementation of FAS123R.

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**FINANCIAL EXPENSES, NET.** Financial expense net, for the three and six months ended June 30, 2006 were \$363 and \$1,302 respectively. Financial expenses for the corresponding periods in 2005 were \$41 and \$99, respectively. The increase in financial expenses, net, during the 2006 periods is primarily attributable to non-cash expenses that we recorded in respect of stock based compensation benefits as well the interest accrued on the loans advanced to the company since April 2005.

**NET LOSS.** For the three and six months ended June 30, 2006 we had a net loss of \$585 and \$1,706, respectively. Net loss for the corresponding periods in 2005 were \$581 and \$772, respectively. The increase in net loss during the 2006 periods is primarily attributable to the non-cash expenses that we recorded in respect of deferred compensation benefits during these periods and which are discussed above under "Financial Expenses, Net".

### LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2006, we had cash and cash equivalents of approximately \$575, compared to \$493 at December 31, 2005.

We generated negative cash flow from operating activities of approximately \$357 during the six months ended June 30, 2006 compared to \$703 for the corresponding period in 2005.

From inception, we have financed our operations primarily from the sale of our securities. Our recent financings are discussed below.

On February 1, 2006 the Company borrowed the principal amount of \$150. This loan bears interest at an annual rate of prime plus 4% and is repayable in four equal installments every three calendar months through January 31, 2007. The Company issued to the holder of this indebtedness a three year warrant to purchase up to 60,000 shares of Common Stock at a per share exercise price of \$0.85. As of June 30, 2006, the Company repaid \$39, representing principal and accrued interest then due.

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In January 2006 we and an institutional investor entered into an agreement pursuant to which we agreed to sell to such investor shares of our Common Stock at \$0.70 per share for aggregate gross proceeds of \$600. The private placement was completed in June, and the Common Stock has been issued is fully paid.

In July 2006, we commenced a private placement of units of our securities comprised of our (i) 8% promissory note that becomes due 12 months following issuance and (ii) warrants as described below. The principal and accrued interest on the promissory is scheduled to be paid in one balloon payment at the end of the twelve month period. Each purchaser of the note would receive warrants, exercisable over a period of two years from the date of issuance, to purchase 16,250 shares of our Common Stock for each \$25 of principal loaned, at 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 our Common Stock during the warrant exercise period. The maximum amount that we can raise under the offering is \$550. As of the date of the filing of this quarterly report on Form 10-QSB, we have raised \$385 in gross proceeds from this offering.

In addition to the \$1,500 we raised in December 2005 from the private placement of our debt instruments and warrants, we obtained an extension of nine months to the scheduled maturity of our convertible promissory notes (collectively the "Notes") in the aggregate principal amount of \$300. The Notes bear interest at an annual rate of 8% and are payable on September 30, 2006. At the election of the holder, the Notes are convertible into our Common Stock at a per share price equal to the lesser of (i) 60% of the per share purchase price of any security subsequently sold by us and (ii) \$0.705.

We need to raise additional funds to be able to satisfy our cash requirements over the next twelve months. Product development, corporate operations and marketing expenses will continue to require additional capital. Our current revenue from operations is insufficient to cover our current operating expenses and projected expansion plans. We therefore are aggressively 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, 2005. While we have raised approximately \$985 in gross proceeds from the issuance of our debt and equity securities since the beginning of 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.

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### 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

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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 June 30, 2006, 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.

During the six months ended June 30, 2006, we issued unregistered securities as follows:

(i) In June 2006, we issued 857,143 shares of our Common Stock to an accredited investor in consideration of \$600 in gross proceeds.

All of the securities above were issued in transactions not involving a public offering and were issued without registration in reliance upon the exemption from registration afforded by Section 4(2) of the Securities Act of 1933, as amended, and Regulation D promulgated thereunder.

#### ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

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

Our annual meeting of stockholders was held on June 12, 2006. The following matters were voted on: (i) election of directors; and (ii) appointment of auditors. The vote tally was as follows:

(i) Proposal to Elect Directors to Serve until the 2007 Annual Meeting of Stockholders.

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|                  | FOR<br>----- | WITHHOLD<br>----- |
|------------------|--------------|-------------------|
| Michael Braunold | 15,113,907   | 1,240             |
| Sidney Braun     | 15,114,661   | 486               |
| Pauline Dorfman  | 15,114,661   | 486               |

(ii) Proposal to ratify the appointment of Brightman Almagor & Co., a member of Deloitte Touche Tohmatsu, as the Company's auditors for the year ending December 31, 2006.

| FOR<br>----- | AGAINST<br>----- | ABSTAIN<br>----- | BROKER NON VOTES<br>----- |
|--------------|------------------|------------------|---------------------------|
|--------------|------------------|------------------|---------------------------|

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15,114,935

149

63

0

All Proposals received the requisite number of votes and were carried.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

31.1 Certifications of Chief Executive Officer

31.2 Certifications of Chief Financial Officer

32.1 Section 1350 Certification

32.2 Section 1350 Certification

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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: September 19, 2006

SPO MEDICAL INC.

/s/ MICHAEL BRAUNOLD

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MICHAEL BRAUNOLD  
PRESIDENT AND CHIEF EXECUTIVE OFFICER

PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER

DATE: September 19, 2006

BY /s/ JEFF FEUER

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JEFF FEUER,  
CHIEF FINANCIAL OFFICER  
(PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER)

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