SPO Medical Inc
Form 10QSB
November 14, 2006

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

MARK ONE

|X| Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period ended September 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 incorporation or organization)	(I.R.S. Employer Identification No.)

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 |X| 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 |X|.

As of November 13, 2006, SPO Medical Inc. had outstanding 19,335,525 shares of common stock, par value $0.01 per share.

Transitional Small Business Disclosure Format (Check one) Yes |_| No |X|

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PART I -- FINANCIAL INFORMATION

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)

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

U.S. dollars in thousands

	September 30, 2006 Unaudited
ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	$ 854
Trade receivables	534
Other accounts receivable and prepaid expenses	89
Inventories	662
	$ 2,139
LONG-TERM INVESTMENTS	
Deposits	11
Severance pay fund	190
	201
PROPERTY AND EQUIPMENT, NET	86
Total assets	$ 2,426
LIABILITIES AND STOCKHOLDERS' DEFICIENCY	
Current Liabilities	
Short-term loans	$ 245
Trade payables	318
Employees and payroll accruals	211
Other payables and accrued expenses	809
	1,583
Long-Term Liabilities	
Long-term loans	1,293
Accrued severance pay	306
	1,599
STOCKHOLDERS' DEFICIENCY	
Stock capital	193
Additional paid-in capital	9,653
Accumulated deficit	(10,602)
	(756)
Total liabilities and stockholders' deficiency	$ 2,426

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

SPO MEDICAL INC.
AND ITS SUBSIDIARY
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands except share data

	Nine months ended		Three
	September 30,		Se
	2006	2005	2006
	Unaudited		
Revenues	$ 2,520	$ 1,224	$
Cost of revenues	1,264	528	
Gross profit	1,256	696	
Operating expenses			
Research and development, net	549	399	
Selling and marketing	463	377	
General and administrative	716	545	
Merger expenses	--	251	-
Total operating expenses	1,728	1,572	
Operating loss	472	876	
Financial expenses, net	4,044	182	2,
Loss for the period	$ 4,516	$ 1,058	$ 2,
Basic and diluted loss per ordinary share	$ (0.24)	$ (0.06)	$ (0
Weighted average number of shares outstanding used in computation of basic and diluted loss per share	18,690,751	17,475,790	19,239,

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 capital	Additional paid-in capital	Deferred compensation	Accumulated deficit
Balance as of January 1, 2004	$ 501	$ 927	$ --	$ (1,512)
Issuance of ordinary shares to consultants	99	1,272	--	--
Stock-based compensation related to options granted to employee	--	283	--	--
Stock-based compensation related to warrant granted to lender	--	78	--	--
Beneficial conversion feature of convertible notes	--	115	--	--
Net Loss	--	--	--	(2,536)
Balance as of December 31, 2004	600	2,675	--	(4,048)
Issuance of ordinary shares upon conversion of loans	35	224	--	--
Warrants issued in private placements	--	949	--	--
Warrants issued in connection with loans	--	22	--	--
Deferred stock-based compensation related to options granted to employees and consultants	--	762	(762)	--
Amortization of deferred Stock-based compensation related to options granted to employees	--	--	187	--
Amortization of deferred Stock-based compensation related to options granted to consultant	--	--	348	--
Reverse merger transaction and forward split of issued share capital	(465)	201	--	--
Net Loss	--	--	--	(2,038)
Balance as of December 31, 2005	170	4,833	(227)	(6,086)
Deferred compensation reclassified due to FAS 123R implementation for the first time	--	(227)	227	--
Warrants issued in connection with loans	--	429	--	--
Deferred stock-based compensation related to options granted to consultants	--	752	--	--
Exercise of warrant by consultant	5	--	--	--
Exercise of convertible note	9	560	--	--
Benefit resulting from changes to warrant terms	--	2,534	--	--
Amortization of deferred Stock-based compensation related to options granted to employees	--	130	--	--
Amortization of deferred Stock-based compensation related to options granted to directors	--	71	--	--
Issuance of ordinary shares	9	571	--	--
Net Loss	--	--	--	(4,516)
Balance as of September 30, 2006, Unaudited	$ 193	$ 9,653	$ --	$(10,602)

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 September 30, 2006	2005	Three months September 2006	
	Unaudited		Unaudited	
Cash Flows from Operating Activities				
Loss for the period	$(4,516)	$(1,058)	$(2,810)	$
Adjustments to reconcile loss to net cash used in operating activities:				
Depreciation	17	5	5	
Stock-based compensation expenses	952	82	50	
Amortization of loan discounts, net	625	--	148	
Benefit resulting from changes to warrant terms	2,534	--	2,534	
Increase (decrease) in accrued severance pay, net	(13)	93	(7)	
Increase in accrued interest payable on loans	114	55	45	
Changes in assets and liabilities:				
Decrease (increase) in trade receivables	(335)	(36)	(83)	
Decrease (increase) in other receivables	(47)	10	(41)	
Increase in inventories	(202)	(307)	(160)	
Increase in accounts payable	93	83	1	
Increase (decrease) in other payables and accrued expenses	331	115	228	
Net cash used in operating activities	(447)	(958)	(90)	
Cash Flows from Investing Activities				
Decrease in short-term investments	--	33	--	
Increase in long-term deposits	(1)	(5)	--	
Purchase of property and equipment	(55)	(29)	(21)	
Net cash used in investing activities	(56)	(1)	(21)	
Cash Flows from Financing Activities				
Issuance of ordinary shares, net	580	--	--	
Exercise of warrant by consultant	5	--	--	
Receipt of short-term loans	152	100	68	
Receipt of long-term loans	--	1,536	--	
Repayment of short-term loans	(301)	(40)	(40)	
Proceeds on grant of exercisable warrants	428	--	362	
Net cash provided by financing activities	864	1,596	390	
Increase in cash and cash equivalents	361	637	279	

Cash and cash equivalents at the beginning of the period	493	8	575	
Cash and cash equivalents at the end of the period	$ 854	$ 645	$ 854	$
Non cash transactions:				
Conversion of convertible notes	$ 569	$ --	$ 569	$

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 September 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 nine months ended September 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 nine and three months ended September 30, 2006, resulted in a net loss of $4,596 and $2,890 respectively, and the Company's balance sheet reflects a net stockholders' deficit of $756. The Company's ability to continue operating as a "going concern" is dependent on its ability to raise sufficient additional 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.

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 nine and three months ended September 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."

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

	NINE MONTHS ENDED September 30, 2005 UNAUDITED	THREE MONTHS ENDED September 30, 2005 UNAUDITED
Net loss, as reported	$1,058	$286
Deduct: Total stock-based compensation expense determined under fair value method for all awards	31	31

Pro forma net loss	$1,089	$317
Basic and diluted net loss per share, as reported	$ 0.06	$ 0.02
Basic and diluted net loss per share, pro forma	$ 0.06	$ 0.02

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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 September 30, 2006, the Company repaid $78 representing principal and accrued interest then due.

NOTE 5: CONVERSION OF OUTSTANDING DEBT

In January 2005, the Company issued to 10 investors its convertible promissory notes (collectively the "Notes") in the aggregate principal amount of $300. The Notes became payable on September 30, 2006 and bore interest at an annual rate of 8%. By their terms, at the election of the holder the Notes are convertible into the Company's Common Stock at a per share price equal to the lesser of (i) 60% of the per share purchase price of any Company security subsequently sold by the Company and (ii) $0.705. All the holders of these convertible promissory notes elected to convert the principal and the accrued interest. The conversion resulted in the issuance to these investors of a total of 948,949 shares of the Company's Common Stock.

NOTE 6: AMENDMENT TO APRIL 2005 PRIVATE PLACEMENT

In December 2005 the Company completed the private placement to certain accredited investors that it commenced in April 2005 for the issuance of up to $1,544 of units of its securities, with each unit comprised of (i) the Company's 18 month 6% promissory note (collectively, the "April 2005 Notes") and (ii) three year warrants to purchase up to such number of shares of the Company's 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, the Company 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 by one year from the original maturity date on the original note, (b) the exercise period of the April 2005 Warrants is to be extended from three to five years 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 the Company subsequently issues shares of its 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 Company 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 Company 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, the Company's obligation to file a registration statement under the Securities Act of 1933, as amended, relating to the resale of the Company's Common Stock underlying the April 2005 Warrants is extended to April 15, 2007.

The Amendment was effective as of September 30, 2006 and the accounting costs related to the Amendment has been fully recognized in the current accounting period. This has resulted in a one time non-cash finance expense in the amount of $2,500.

NOTE 7: 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 8: JULY 2006 PRIVATE PLACEMENT

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 Company raised $550, which is the maximum amount that can be raised under the offering. As at September 30, 2006 the Company had recorded $430.

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, 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 profusion. 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 our common stock, par value $0.01 (the "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 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 distribution center of the Company.

We also generate revenues from the provision of research and development services. Revenues generated from research and development services are recognized when such services are performed.

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.

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 NINE AND THREE MONTHS ENDED SEPTEMBER 30, 2006 AND THE NINE AND THREE MONTHS ENDED SEPTEMBER 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 nine and three months ended September 30, 2006 were $2,520,000 and $929,000 respectively. Revenues for the corresponding periods in 2005 were $1,224,000 and $482,000 respectively. The increase in revenues during the 2006 periods primarily reflects 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. Currently, two 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 such resellers could have a material adverse effect on our results of operation.

COST OF REVENUES. Cost of revenues for the nine and three months ended September 30, 2006 were $1,264,000 and $435,000, respectively. Cost of revenues for the corresponding periods in 2005 were $528,000 and $193,000 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. The 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 relating to 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 nine and three months ended September 30, 2006 were $549,000 and $204,000, respectively. Research and development expenses for the corresponding periods in

2005 were $399,000 and $140,000, respectively. The increase in research and development expenses during the 2006 periods as compared to the 2005 periods is also attributable to increased compensation and facility lease expenses and non cash expenses that we recorded as a result of the implementation of FAS123R as well as expenses incurred in connection with our continuing product enhancement efforts and 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 nine and three months ended September 30, 2006 were $463,000 and $161,000, respectively. Selling and marketing expenses for the corresponding periods in 2005 were $377,000 and $141,000, respectively. The increase in selling and marketing expenses during the 2006 periods is also attributable to increased compensation expenses and non cash expenses that we recorded as a result of the implementation of FAS 123R 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 and accounting services. General and administrative expenses for the nine and thee months ended September 30, 2006 were $716,000 and $197,000 respectively. General and administrative expenses for the corresponding periods in 2005 were $545,000 and $211,000, respectively. The increase in general and administrative expenses during the 2006 periods as compared to the 2005 period is primarily attributable to increased 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 FAS 123R.

FINANCIAL EXPENSES, NET. Financial expense net, for the nine and three months ended September 30, 2006 were $4,044,000 and $2,742,000 respectively. Financial expenses for the corresponding periods in 2005 were $182,000 and $83,000, 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, of which $2,500,000 is attributable to the amendment to the April 2005 Notes discussed further below.

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NET LOSS. For the nine and three months ended September 30, 2006 we had a net loss of $4,516,000 and $2,810,000, respectively. Net loss for the corresponding periods in 2005 were $1,058,000 and $286,000, respectively. The increase in net loss during the 2006 periods is primarily attributable to the non-cash expenses that we recorded in respect of stock based compensation benefits during these periods, which are discussed above under "Financial Expenses, Net".

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2006, we had cash and cash equivalents of approximately $854,000, compared to $493,000 at December 31, 2005.

We generated negative cash flow from operating activities of approximately $447,000 during the nine months ended September 30, 2006 compared to $958,000 for the corresponding period in 2005.

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 by one year from the original maturity date on the original note, (b) the exercise period of the April 2005 Warrants is to be extended from three to five years 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 $2,500,000 being recognized in the current period. As of November 13, 2006, holders of Notes in the principal amount $489,000 have signed the Amendment and the holder of a note in the principal amount of $50,000 which is scheduled to mature on November 30, 2006, has requested repayment of principle and accrued interest. The Company is currently in contact with the remaining note holders of the April 2005 Notes with respect to obtaining their formal execution of the Amendment.

From inception, we have financed our operations primarily from the sale of our securities. Our recent financings in 2006 are discussed below.

On February 1, 2006 we borrowed the principal amount of $150,000. 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. We 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 September 30, 2006, we repaid $78,000, representing principal and accrued interest then due.

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 $600,000. The private placement was completed in June 2006.

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 form the date of issuance, to purchase 16,250 shares of our Common Stock for each $25,000 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 $550,000. As of the date of the filing of this quarterly report on Form 10-QSB, we have raised $550,000 in gross proceeds from this offering.

Additionally, 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 $300,000. The Notes became payable on September 30, 2006; interest accrued at a per annum rate of 8%. 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. In September 2006, the outstanding principal and accrued interest were converted into 948,949 shares of our Common Stock.

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 $1,300,000 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.

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, 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 three months ended September 30, 2006, we issued unregistered securities as follows:

(i) In September 2006, we issued 948,949 shares of our Common Stock upon the conversion of $342,000 in principal and accrued interest of notes that the Company issued.

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.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

4.1 Form of Promissory Note issued in connection with the Subscription Agreement referred to in Item 10.1

4.2 Form of Warrant issued in connection with the Agreement referred to in Item 10.1

10.1 Form of Subscription Agreement between the Company and certain Buyers

10.2 Form of First Amendment to Subscription Agreement between the Company and parties thereto.

31.1 Certifications of Chief Executive Officer

31.2 Certifications of Chief Financial Officer

32.1 Section 1350 Certification

32.2 Section 1350 Certification

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 14, 2006 SPO MEDICAL INC.

/s/ MICHAEL BRAUNOLD

MICHAEL BRAUNOLD
PRESIDENT AND CHIEF EXECUTIVE OFFICER

PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER

DATE: November 14, 2006 BY /s/ JEFF FEUER

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