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CAPRIUS INC  
Form 10QSB  
May 16, 2005

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

FORM 10-QSB

(Mark one)

Quarterly Report under Section 13 or 15 (d) of the  
Securities Exchange Act of 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2005

Transition Report Pursuant to Section 13 or 15 (d) of the  
Securities Exchange Act of 1934

Commission File Number: 0-11914

CAPRIUS, INC.  
(Exact name of small business issuer as specified in its charter)

Delaware  
-----  
(State or other jurisdiction of  
incorporation or organization)

22-2457487  
-----  
(I.R.S. Employer  
Identification No.)

One Parker Plaza, Fort Lee, NJ 07024  
-----  
(Address of principal executive offices) (Zip Code)

Issuer's telephone number: (201) 592-8838

N/A

-----  
(Former name, former address, and former fiscal year, if changed  
since last report.)

Indicate by check mark whether the registrant (1) filed all reports  
required to be filed under 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 \_\_\_

State the number of shares outstanding of issuer's classes of common  
equity, as of the latest practicable date.

Class	Outstanding at May 11, 2005
Common Stock. Par value \$0.01	3,321,673 shares *

\* Gives retroactive effect to 1-for-20 reverse stock split,  
effective April 5, 2005

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## CAPRIUS, INC. AND SUBSIDIARIES

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CAPRIUS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEET  
As of March 31, 2005  
(UNAUDITED)

ASSETS

CURRENT ASSETS:

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Cash and cash equivalents	\$ 2,702,707
Accounts receivable, net of reserve for bad debts of \$5,163	258,016
Inventories, net	617,596
Other current assets	6,396
	-----
Total current assets	3,584,715
	-----
PROPERTY AND EQUIPMENT:	
Office furniture and equipment	167,221
Equipment for lease	76,666
Leasehold improvements	19,536
	-----
	263,423
Less: accumulated depreciation	209,254
	-----
Property and equipment, net	54,169
	-----
OTHER ASSETS:	
Goodwill	737,010
Intangible assets, net of accumulated amortization of \$635,417	404,583
Other	13,330
	-----
Total other assets	1,154,923
	-----
TOTAL ASSETS	\$ 4,793,807
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable	520,759
Accrued expenses	136,157
Accrued compensation	293,072
	-----
Total current liabilities	949,988
	-----
COMMITMENTS AND CONTINGENCIES	-
STOCKHOLDERS' EQUITY:	
Preferred stock, \$.01 par value (stated value at \$100)	
Authorized - 1,000,000 shares	
Issued and outstanding - Series A, none; Series B, convertible, 27,000 shares. Liquidation preference \$2,700,000	2,700,000
Series C, convertible 66,681 shares. Liquidation preference \$6,668,100	6,668,100
Common stock, \$.01 par value	
Authorized - 50,000,000 shares, issued 1,023,453 shares and outstanding 1,022,328 shares	10,235
Additional paid-in capital	67,596,648
Accumulated deficit	(73,128,914)
Treasury stock (1,125 common shares, at cost)	(2,250)
	-----
Total stockholders' equity	3,843,819

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TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY

-----  
\$ 4,793,807  
=====

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

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CAPRIUS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

	For the three months ended		
	March 31, 2005	March 31, 2004	Ma
	-----	-----	-----
REVENUES:			
Product sales	\$ 199,700	\$ 158,739	\$
Equipment rental income	2,624	16,334	
Consulting & royalty fees	42,228	12,500	
	-----	-----	-----
Total revenues	244,552	187,573	
	-----	-----	-----
OPERATING EXPENSES:			
Cost of product sales and equipment rental income	168,596	169,459	
Research and development	116,916	53,707	
Selling, general and administrative	602,356	909,467	
	-----	-----	-----
Total operating expenses	887,868	1,132,633	
	-----	-----	-----
Operating loss	(643,316)	(945,060)	
Other income	132,200	-	
Interest expense, net	(181,941)	(2,551)	
	-----	-----	-----
Loss from continuing operations	(693,057)	(947,611)	
Loss from operations of discontinued Strax Business	-	-	
	-----	-----	-----
Net loss	\$ (693,057)	\$ (947,611)	\$
	=====	=====	=====
Net loss per basic and diluted common share			
Continuing operations	\$ (0.47)	\$ (0.93)	\$
Discontinued operations	-	-	
	-----	-----	-----
Net loss per basic and diluted common share	\$ (0.47)	\$ (0.93)	\$
	=====	=====	=====
Weighted average number of common shares outstanding, basic and diluted	1,482,197	1,022,328	
	=====	=====	=====

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CAPRIUS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' (DEFICIENCY) EQUITY  
(UNAUDITED)

	Series B Convertible Preferred Stock		Series C Convertible Preferred Stock	
	Number of Shares	Amount	Number of Shares	Amount
BALANCE, SEPTEMBER 30, 2004 (SEE NOTE 10)	27,000	\$ 2,700,000	-	\$
Issuance Series C Mandatory Convertible Preferred Stock (see Note 7)			45,000	4,500,
Conversion of secured convertible notes and bridge financing into Series C Mandatory Convertible Preferred Stock			21,681	2,168,
NET LOSS				
BALANCE, MARCH 31, 2005	27,000	\$ 2,700,000	66,681	\$ 6,668,

(TABLE CONTINUED)

	Additional Paid-in Capital	Accumulated Deficit	Treasury St
			Number of Shares
BALANCE, SEPTEMBER 30, 2004 (SEE NOTE 10)	\$ 68,031,614	\$ (71,638,785)	1,125
Issuance Series C Mandatory Convertible Preferred Stock (see Note 7)	(434,966)		
Conversion of secured convertible notes and bridge financing into Series C Mandatory Convertible Preferred Stock			
NET LOSS		(1,490,129)	

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BALANCE, MARCH 31, 2005 \$ 67,596,648 \$ (73,128,914) 1,125 \$

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

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CAPRIUS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	Six Months End 2005
	-----
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net loss	\$ (1,490,129)
Adjustments to reconcile net loss to net cash used in operating activities:	
Amortization of debt discount	165,220
Amortization of deferred financing costs	89,542
Depreciation and amortization	157,171
Interest on secured convertible notes	95,300
Changes in operating assets and liabilities:	
Accounts receivable	(184,533)
Inventories	159,099
Other assets	8,826
Accounts payable and accrued expenses	(527,770)
	-----
Net cash used in operating activities	(1,527,274)
	-----
CASH FLOWS FROM INVESTING ACTIVITIES:	
Proceeds from sale of Strax business	66,000
Acquisition of property and equipment	(1,436)
	-----
Net cash provided by investing activities	64,564
	-----
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from issuance of notes payable - related party	-
Proceeds from short term loan	100,000
Repayment of short term loan	(100,000)
Proceeds from short term loans - related party	145,923
Repayment of short term loans - related party	(73,123)
Net proceeds from issuance of Series C Preferred Stock	4,065,034
	-----
Net cash provided by financing activities	4,137,834
	-----
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	2,675,124
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	27,583

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CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 2,702,707
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:	
Cash paid for interest during the period	\$ 33,508
Cash paid for income taxes during the period	\$ 192,672
NON CASH-FLOW ITEMS:	
Transfer of net book value of certain equipment for leases to inventory	\$ 66,177
Conversion of secured convertible notes and interest into equity	\$ 1,595,300
Conversion of notes payable -related party into equity	\$ 500,000
Conversion of short-term loans payable - related party into equity	\$ 72,800

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

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### CAPRIUS, INC. AND SUBSIDIARIES

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

##### NOTE 1 - BASIS OF PRESENTATION

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The condensed consolidated balance sheet as of March 31, 2005 and the condensed consolidated statements of operations for the three month periods ended March 31, 2005 and 2004, and for the six month periods ended March 31, 2005 and 2004, the condensed consolidated statement of stockholders' equity for the six month period ended March 31, 2005 and the condensed consolidated statements of cash flows for the six month period ended March 31, 2005 and 2004, have been prepared by the Company without audit. In the opinion of management, the information contained herein reflects all adjustments necessary to make the presentation of the Company's condensed financial position, results of operations and cash flows not misleading. All such adjustments are of a normal recurring nature. This quarterly report gives retroactive effect to the Company's 1-for-20 reverse common stock split of April 5, 2005.

The accompanying condensed consolidated financial statements do not contain all of the information and disclosures required by accounting principles generally accepted in the United States of America and should be read in conjunction with the consolidated financial statements and related notes included in the Company's annual report on Form 10-KSB for the fiscal year ended September 30, 2004.

##### NOTE 2 - THE COMPANY

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Caprius, Inc. ("Caprius", the "Company", "we", "us" and "our") is

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engaged in the infectious medical waste disposal business. In the first quarter of Fiscal 2003, we acquired a majority interest in M.C.M. Environmental Technologies, Inc. ("MCM") which developed, markets and sells the SteriMed and SteriMed Junior compact systems that simultaneously shred and disinfect Regulated Medical Waste. The SteriMed Systems are sold and leased in both the domestic and international markets.

In December 2002, the Company closed the acquisition of our initial investment of 57.53% of the capital stock of MCM for a purchase price of \$2.4 million. MCM wholly-owns MCM Environmental Technologies Ltd., an Israeli corporation, which initially developed the SteriMed Systems. Upon closing, our designees were elected to three of the five seats on MCM's Board of Directors, with George Aaron, President and CEO, and Jonathan Joels, CFO, filling two seats. Additionally, as part of the transaction, certain debt of MCM to its existing stockholders and to certain third parties was converted to equity in MCM or restructured. As part of the Stockholders Agreement dated December 17, 2002, there were certain provisions relating to performance adjustments for the twenty four month period post closing. As a consequence, the Company's ownership interest increased by 5% in the fiscal year 2004.

During the first quarter of fiscal year 2005, an agreement was reached between the Company and the 20% minority ownership of an MCM subsidiary which has been dormant since inception. The minority shareholders shall be repaid their initial investment, by way of a credit towards the site installation expense of SteriMed units that they are purchasing for their dialysis centers. This subsidiary was dissolved on February 9, 2005.

### NOTE 3 - SUMMARY OF CERTAIN SIGNIFICANT ACCOUNTING POLICIES

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#### Stock Based Compensation

At March 31, 2005, the Company had three stock based compensation plans (one incentive and nonqualified, one employee and one non-employee director plan). The Company accounts for these plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and complies with the disclosure requirements of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-based

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Compensation" as amended by SFAS No. 148, "Accounting for Stock-based Compensation - Transition and Disclosure, an amendment of SFAS No. 123, issued in December 2002. Under APB Opinion No. 25, compensation expense is based on the difference, if any, generally on the date of grant, between the fair value of our stock and the exercise price of the option. No stock-based employee compensation cost is reflected within the statement of operations for the three and six month periods ended March 31, 2005 and 2004.

If the Company had elected to recognize compensation costs for the Company's option plans using the fair value method at the grant dates, the effect on the Company's net loss and loss per share for the periods shown below would have been as follows:



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	Three months ended March 31,		Six months ended March 31,	
	2005	2004	2005	2004
	-----	-----	-----	-----
Net loss as reported	\$ (693,057)	\$ (947,611)	\$ (1,490,129)	\$ (1,605,129)
Deduct:				
Stock-based employee compensation determined under fair value method for all awards, net of related tax effects	(748)	(13,687)	(1,495)	(27,000)
	-----	-----	-----	-----
Pro forma net loss	\$ (693,805)	\$ (961,298)	\$ (1,491,624)	\$ (1,632,129)
	=====	=====	=====	=====
Basic and diluted loss per share of Common Stock				
As reported	\$ (0.47)	\$ (0.93)	\$ (1.19)	\$ (1.19)
Pro forma	\$ (0.47)	\$ (0.94)	\$ (1.19)	\$ (1.19)

Loss Per Share

The Company follows Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings Per Share", which provides for the calculation of "basic" and "diluted" earnings (loss) per share. Basic loss per share includes no dilution and is computed by dividing loss available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted loss per share reflects the potential dilution that could occur through the effect of common shares issuable upon the exercise of stock options and warrants and convertible securities. For the periods ended March 31, 2005 and 2004, potential common shares amount to 3,245,149 and 334,411 respectively, and have not been included in the computation of diluted loss per share since the effect would be antidilutive.

Revenue Recognition

The medical infectious waste business recognizes revenues from either the sale or rental of its SteriMed units. Revenues for sales are recognized at the time that the unit is shipped to the customer. Rental revenues are recognized based upon either services provided for each month of activity or evenly over the year in the event that a fixed rental agreement is in place.

Impairment of Long-Lived Assets

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Company and its subsidiaries review the carrying values of their long-lived assets (other than goodwill) for possible impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable. Any long-lived assets held for disposal are reported at the lower of their carrying amounts or fair

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values less costs to sell.

### Goodwill and Other Intangibles

The Company has adopted the provisions of SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 141 is effective as to any business combination occurring after June 30, 2001 and certain transition provisions that affect accounting for business combinations prior to June 30, 2001 are effective as of the date SFAS No. 142 is applied in its entirety. Goodwill relating to acquisitions completed subsequent to June 30, 2001 is not amortized and is subject to impairment testing. In addition, effective January 1, 2002, the Company will no longer be required to amortize goodwill and certain other intangibles assets relating to acquisitions completed prior to July 1, 2001.

SFAS No. 142 provides, among other things, that goodwill and intangible assets with indeterminate lives shall not be amortized. Goodwill shall be assigned to a reporting unit and annually tested for impairment. Intangible assets with determinate lives shall be amortized over their estimated useful lives, with the useful lives reassessed continuously, and shall be assessed for impairment under the provisions of SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of". Goodwill is also assessed for impairment on an interim basis when events and circumstances warrant. The Company assesses whether an impairment loss should be recognized and measured by comparing the fair value of the "reporting unit" to the carrying value, including goodwill. If the carrying value exceeds fair value, then the Company will compare the implied fair value of the goodwill (as defined in SFAS No. 142) to the carrying amount of the goodwill. If the carrying amount of the goodwill exceeds the implied fair value, then the goodwill will be adjusted to the implied fair value. At September 30, 2004, goodwill results from the excess of cost over the fair value of net assets acquired related to the MCM business.

### NOTE 4 - INVENTORIES

Inventories consist of the following, net of reserves of approximately \$34,200 at March 31, 2005:

Raw materials	\$276,499
Finished goods	341,097
	-----
	\$617,596
	=====

### NOTE 5 - NOTES PAYABLE

On February 2, 2005, the Company raised \$100,000 through the issuance of 8% Senior Secured Convertible Promissory Notes, repayable, together with interest to April 3, 2005, subject to prepayment in the event of an equity financing in excess of \$2 Million, or conversion by the investors into shares of the Company's common stock at a conversion price of \$3.00 per share. The lenders also received warrants to purchase 5,000 shares of the Company's common stock exercisable at \$5.60 per share for a period of five years. The allocated fair value of these warrants are deemed to be immaterial. On February 17, 2005 the Company repaid this loan together with interest.

During the third quarter of fiscal 2004, the Company raised an aggregate of \$1.5 million through the issuance of 8% Senior Secured Convertible Promissory Notes ("the Notes"), prior to underwriting fees and expenses. The

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Company granted a security interest in substantially all of the assets of the Company. The Notes were to mature in one year and convert into shares of common stock at the election of the investor at any time at a conversion price of \$4.00

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per share, subject to reduction if certain conditions were not met as of September 30, 2004. The conditions were not met and the conversion price was reduced to \$3.00 per share. The beneficial conversion feature of the Notes, amounted to \$200,000 and as such the amount was treated as a discount to debt and a corresponding increase to paid-in capital. This amount is being amortized over the life of the loan (which was accelerated to February 15, 2005). Amortization for the six month period ended March 31, 2005 amounted to \$150,000 and that amount is included in interest expense, net in the consolidated statement of operations. The financing was arranged through Sands Brothers International Ltd. ("Sands") who were retained by the Company to act as selected dealer for the sale and issuance of the Notes. Based upon the funds raised, Sands received a six percent cash fee and an expense allowance of one percent of the gross proceeds, plus warrants valued at \$28,500 using the Black Scholes Model to purchase 71,250 shares of the Company's common stock at an exercise price of \$5.60 per share for a period of five years. The total fees for the offering were \$125,000. The debt issuance costs are being amortized over the term of the loan (which was accelerated to February 15, 2005). Amortization for the six month period ended March 31, 2005 amounted to \$89,542 and that amount is included in interest expense, net in the consolidated statement of operations. On February 15, 2005 the Company closed on a \$4.5 million preferred stock equity financing (see Note 7). As a condition of this financing, the holders of the Notes amended and converted their Notes together with accrued interest, into an aggregate of 15,953 shares of Series C Mandatory Convertible Preferred Stock and the security interest was terminated.

### NOTE 6 - NOTES PAYABLE - RELATED PARTY TRANSACTIONS

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During the period from January 1, 2005 through February 15, 2005, the Company was advanced the principal amount of approximately \$7,100 through short term loans until additional equity funding is secured. The terms of the loans are identical to the terms of the \$100,000 8% Senior Secured Convertible Promissory Note in Note 5. The lender also received warrants to purchase 355 shares of the Company's common stock exercisable at \$5.60 per share for a period of five years. The allocated fair value of the warrants associated with this advance are deemed to be immaterial. These short-term loans were provided by an executive officer, Mr. Koppel. As a condition of this financing, Mr. Koppel exchanged 50% of his indebtedness for 34 shares of Series C Mandatory Convertible Preferred Stock and on February 15, 2005 was paid the balance inclusive of interest.

During the three month period ended December 31, 2004, the Company was advanced the principal amount of \$138,790 through short term loans until additional equity funding was secured. The terms of the loans are identical to the terms of the \$100,000 8% Senior Secured Convertible Promissory Note in Note 5. The lenders also received warrants to purchase 6,940 shares of the Company's common stock exercisable at \$5.60 per share for a period of five years. The allocated fair value of the warrants associated with this advance are deemed to be immaterial. These short-term loans were provided by executive officers, Messrs. Aaron, Joels, and Koppel who advanced \$64,000, \$62,350 and \$12,440, respectively. As a condition of this financing, the holders of the Notes exchanged 50% of their indebtedness for 694 shares of Series C Mandatory Convertible Preferred Stock and on February 15, 2005 were paid the balance of

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their notes inclusive of interest.

During the second quarter of fiscal 2004, the Company authorized a short-term bridge loan for an aggregate of \$500,000 through the issuance of loan notes due on July 31, 2005. The majority of the funds were provided by management of the Company. The loan notes bear interest at a rate of 11% per annum and were secured by a first lien on any royalties received by Opus Diagnostics Inc. from Seradyn, Inc. in accordance with their Royalty Agreement. For every sixty dollars (\$60.00) loaned, the lender received two warrants to purchase one share of Common Stock, exercisable at \$5.00 per share for a period of five years. The warrants were valued at \$27,400 using the Black Scholes Model and such amount was treated as a discount to debt and a corresponding increase to paid in capital. The discount is being amortized over the life of the loan (which was accelerated to February 15, 2005). For the six month period ended March 31, 2005, the Company recorded an additional interest expense related to this discount of approximately \$15,200. On February 15, 2005 the Company closed on a \$4.5 million preferred stock equity financing (see Note 7). As a condition of this financing the holders of the Notes converted their notes, into an aggregate of 5,000 shares of Series C Mandatory Convertible Preferred Stock and the security interest was terminated.

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### NOTE 7 - EQUITY FINANCING

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On February 15, 2005, the Company closed on a \$4.5 million preferred stock equity financing transaction before financing fees and expenses of approximately \$435,000. As part of this financing transaction, the Company issued 45,000 shares of Series C Mandatory Convertible Preferred Stock ("Series C Stock") at a stated value of \$100 per share. The Company also issued Series A Warrants to purchase an aggregate of 465,517 shares of common stock at an exercise price of \$5.60 per share for a period of five years. In addition, the Company issued Series B Warrants to purchase an aggregate of 155,172 shares of common stock at an exercise price of \$2.90 per share for a period of five years exercisable after nine months, subject to a termination condition as defined in the warrant agreement. The Company determined that the preferred stock was issued with an effective beneficial conversion feature of approximately \$125,000 based upon the relative fair values of the preferred stock and warrants. The Company calculated the fair values of the warrants using the Black Scholes valuation model. Upon conversion of the Series C Stock to common shares the Company shall record a deemed preferred stock dividend of approximately \$125,000; which represents the beneficial conversion feature of the Series C Stock (See Note 11).

Simultaneously, the Company converted the short-term secured debt outstanding in the aggregate of approximately \$2.1 million inclusive of interest, together with \$72,962 of unsecured indebtedness, into 21,681 shares of Series C Stock. As part of the condition for raising the equity financing, holders of a majority of the outstanding shares irrevocably undertook to effect a 1:20 reverse stock split of any outstanding shares of common stock ("the Reverse Split"). Upon the effectiveness of the Reverse Split ("the Mandatory Conversion Date"), the new equity investors and the debt holders who converted their debt agreed to automatically convert their Series C Stock into common shares at a conversion price of \$2.90 per share and/or 2,299,345 shares of the Company's common stock (post reverse split), subject to adjustment in certain circumstances, (see Note 11). The Company also agreed to increase the number of independent directors by one additional director.

### NOTE 8 - OTHER INCOME

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During the second quarter of fiscal 2005, the Company recorded income of \$132,200 as a result of favorable settlements of certain outstanding accounts payable balances.

### NOTE 9 - ECONOMIC DEPENDENCY

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For the six months ended March 31, 2005, revenue from four customers was approximately \$221,000, \$91,000, \$63,000 and \$55,000 which represented approximately 85% of the total revenue. At March 31, 2005 accounts receivable from these customers were approximately \$175,000, \$0, \$42,000, and \$25,000 respectively.

For the six months ended March 31, 2004, revenue from two customers was approximately \$237,000 and \$124,000, which represented approximately 76% of the total revenue.

### NOTE 10 - LITIGATION

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In June 2002, Jack Nelson, a former Caprius executive officer and director, commenced two legal proceedings against us and George Aaron and Jonathan Joels, executive officers, directors and principal stockholders. The two complaints alleged that the individual defendants made misrepresentations to the plaintiff upon their acquisition of a controlling interest in the Company in 1999 and thereafter made other alleged misrepresentations and engaged in mismanagement and other misconduct and took other actions as to the plaintiff to the supposed detriment of the plaintiff and Caprius. One action was brought in Superior Court of New Jersey, Bergen County ("State Court Action"), and the other was brought as a derivative action in Federal District Court in New Jersey ("Federal Derivative Action"). In September 2003, we resolved the State Court Action by making an Offer of Judgment which was accepted by the plaintiff. Under the terms of the Offer of Judgment, which was made without any admission or finding of liability on part of the defendants, we paid \$125,000 to the plaintiff and the action was discontinued.

On May 3, 2004, the Court in the Federal Derivative Action granted the motion made by us and Messrs. Aaron and Joels for judgment on the pleadings based upon the pre-suit demand requirement and dismissed the plaintiff's complaint without prejudice, but denied defendants' motion for judgment on the pleadings based upon the Private Securities Litigation Reform Act. The Court also granted the plaintiff's cross-motion to file an amended complaint to add allegations of insider trading.

In September 2002, we were served with a complaint naming us and our principal officers and directors in the Federal District Court of New Jersey as a purported class action (the "Class Action"). The allegations in the complaint cover the period between February 14, 2000 and June 20, 2002. The initial plaintiff is a relative of the wife of the plaintiff in the State Court Action and Federal Derivative Action. The allegations in the purported Class Action were substantially similar to those in the other two Actions. The complaint sought an unspecified amount of monetary damages, as well as the removal of the defendant officers as shareholders.

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Derivative Action, the Court granted the defendants' motion and dismissed the Class Action. The federal securities claims asserted by the plaintiffs were dismissed with prejudice, and having dismissed all federal law claims, the Court declined to exercise jurisdiction over the remaining state law claims and dismissed those claims without prejudice. On May 14, 2004, the plaintiffs filed a motion for reconsideration, which defendants opposed and subsequently this motion for reargument was denied. The plaintiff did not file a notice of appeal during the statutory time period.

On September 30, 2004, our Board received a letter written from Mr. Nelson's attorney making a demand that we institute a derivative action substantially similar to the allegations presented in the Federal Derivative Action. A draft complaint was included with the letter. An Independent Committee of the Board responded to the letter within the stipulated 90 day period that Mr. Nelson had requested, stating that the Independent Committee determined that there was no basis for the Company to institute the derivative action as demanded. There has been no further communication from Mr. Nelson's attorney.

The independent directors have authorized us to advance the legal expenses of Messrs. Aaron and Joels in these litigations with respect to claims against them in their corporate capacities, subject to review of the legal bills and compliance with applicable law, and Messrs. Aaron and Joels will repay us in the event it was determined that they were not entitled to be indemnified as to the claim for which the advance was made.

### NOTE 11 - SUBSEQUENT EVENT

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On April 5, 2005, the Company effected the Reverse Split. On such date, the 66,681 outstanding shares of Series C Stock automatically converted into 2,299,345 shares of the Company's common stock. As a result of the Reverse Split, the Company has outstanding 3,321,673 shares of common stock. The reverse split did not change the number of authorized shares of common and preferred stock. All share and per share information in the accompanying financial statements have been restated to reflect the 1 for 20 reverse stock split.

### ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

#### FORWARD LOOKING STATEMENTS

The Company is including the following cautionary statement in this Quarterly Report of Form 10-QSB to make applicable and take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 for any forward-looking statements made by, or on behalf of, the Company. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements which are other than statements of historical facts. Certain statements contained herein are forward-looking statements and accordingly involve risks and uncertainties which could cause actual results or outcomes to differ materially from those expressed in the forward-looking statements. Our expectations, beliefs and projections are expressed in good faith and are believed by us to have a reasonable basis, including without limitation, management's examination of historical operating trends, data contained in our records and other data available from third parties, but there can be no assurance that management's expectation, beliefs or projections will result or be achieved or accomplished. In addition to other factors and matters discussed elsewhere herein, the following are important factors that, in our view, could cause actual results to differ materially from those discussed in the forward-looking statements: technological advances by our competitors, changes in health care reform, including reimbursement programs, changes to regulatory requirements relating to environmental approvals for the treatment of infectious

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medical waste, capital needs to fund any delays or extensions of development programs, delays in the manufacture of new and existing products by us or third party contractors, the loss of any key employees, the outcome of existing litigations, delays in obtaining federal, state or local regulatory clearance for new installations and operations, changes in governmental regulations, the location of the MCM business in Israel, and availability of capital on terms satisfactory to us. We are also subject to numerous Risk Factors relating to manufacturing, regulatory, financial resources and personnel as described in the Company's Form SB-2 (File No. 333-124096) dated April 15, 2005) as filed with the Securities and Exchange Commission. We disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date hereof.

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### RESULTS OF OPERATIONS

As more fully described in the Form 10-KSB for fiscal year ended September 30, 2004, our continuing operation is classified as medical infectious waste business.

THREE MONTHS ENDED MARCH 31, 2005 COMPARED TO THREE MONTHS ENDED MARCH 31, 2004  
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Revenues generated from MCM product sales totaled \$199,700 for the three months ended March 31, 2005 as compared to \$158,739 for the three months ended March 31, 2004. Revenues generated from MCM rentals totaled \$2,624 as compared to \$16,334 for the comparable periods. Consulting and royalty income from the TDM Business, which was sold in 2002, totaled \$42,228 as compared to \$12,500 for the three months ended March 31, 2005 and 2004.

Cost of product sales and leased equipment amounted to \$168,596 or 69.0% of total revenues versus \$169,459 or 90.4% of total revenues for the three month period ended March 31, 2005 and 2004, respectively. We have not advanced to a level of sales for us to fully absorb the fixed costs related to our revenues.

Research and development expense increased to \$116,916 versus \$53,707 for the three month period ended March 31, 2005 as compared to the same period in 2004. This was a result of our continuing efforts to improve our products, streamline the manufacturing processes and reduce the product cost.

Selling, general and administrative expenses totaled \$602,356 for the three months ended March 31, 2005 versus \$909,467 for the three months ended March 31, 2004. This reduction was due to a significant decrease in the cost of legal and accounting fees incurred primarily in connection with prior and settled litigations.

Other income totaled \$132,200 for the three months ended March 31, 2005 as compared to \$0 for the three months ended March 31, 2004. This resulted from the favorable settlement of certain outstanding liabilities.

Interest expense, net totaled \$181,941 for the three months ended March 31, 2005 versus \$2,551 for the three months ended March 31, 2004. The majority of the interest expense incurred during the three month period ended March 31, 2005, related to interest fees and amortization in connection with the secured convertible notes and bridge financing, which occurred in Fiscal 2004.

The net loss amounted to \$693,057 and \$947,611 for the three month

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periods ended March 31, 2005 and 2004, respectively.

SIX MONTHS ENDED MARCH 31, 2005 COMPARED TO SIX MONTHS ENDED MARCH 31, 2004  
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Revenues generated from MCM product sales totaled \$436,608 for the six months ended March 31, 2005 as compared to \$417,623 for the six months ended March 31, 2004. Revenues generated from MCM rentals totaled \$7,950 as compared to \$34,683 for the comparable periods. Consulting and royalty income from the TDM Business, which was sold in 2002, totaled \$62,653 as compared to \$25,000 for the six months ended March 31, 2005 and 2004.

Cost of product sales and leased equipment amounted to \$330,390 or 65.2% of total revenues versus \$374,178 or 78.4% of total revenues for the six month period ended March 31, 2005 and 2004, respectively. We have not advanced to a level of sales for us to fully absorb the fixed costs related to our revenues.

Research and development expense increased to \$193,496 versus \$93,302 for the six month period ended March 31, 2005 as compared to the same period in 2004. This was a result of our continuing efforts to improve our products, streamline the manufacturing processes and reduce the product cost.

Selling, general and administrative expenses totaled \$1,274,634 for the six months ended March 31, 2005 versus \$1,583,703 for the six months ended March 31, 2004. This reduction was due to a significant decrease in the cost of legal

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and accounting fees incurred primarily in connection with prior and settled litigations.

Other income totaled \$132,200 for the six months ended March 31, 2005 as compared to \$0 for the six months ended March 31, 2004. This resulted from the favorable settlement of certain outstanding liabilities.

Interest expense, net totaled \$331,020 for the six months ended March 31, 2005 versus \$2,985 for the six months ended March 31, 2004. The majority of the interest expense incurred during the six month period ended March 31, 2005, related to interest fees and amortization in connection with the secured convertible notes and bridge financing, which occurred in Fiscal 2004.

The loss from continuing operations amounted to \$1,490,129 and \$1,576,862 for the six month periods ended March 31, 2005 and 2004, respectively.

### LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2005 the Company's cash and cash equivalents position approximated \$2,703,000 versus \$19,100 at December 31, 2004. As further discussed below, on February 15, 2005 we received net proceeds of approximately \$4 million from the sale of Series C Preferred Stock and warrants, and approximately \$2.1 million of indebtedness was converted into or exchanged for Series C Preferred Stock.

On January 14, 2005 we received advances of approximately \$7,100 through short-term related party loans until additional equity funding was secured. The terms of the loans are identical to the terms of the \$100,000 8%



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Senior Secured Convertible Promissory Note outlined in Note 5 to the Notes to the Financial Statements in Item 1. These funds were utilized for general working capital purposes. These loans were repaid on February 15, 2005 as part of the Preferred Stock Equity Financing arrangement.

On February 2, 2005 we raised \$100,000 through the issuance of an 8% Senior Secured Convertible Promissory Note, due April 3, 2005, subject to repayment in the event of an equity financing in excess of \$2 million or conversion by the investors to shares of our common stock at \$ 3.00 per share. This loan was repaid on February 17, 2005 as part of the Preferred Stock Equity Financing arrangement.

On February 15, 2005, the Company closed on a \$4.5 million preferred stock equity financing before financing related fees and expenses of approximately \$435,000. The Company issued 45,000 shares of Series C Mandatory Convertible Preferred Stock at a stated value of \$100 per share. The Company also issued Series A Warrants to purchase an aggregate of 465,517 shares of common stock at an exercise price of \$5.60 per share for a period of five years. In addition, the Company issued Series B Warrants to purchase an aggregate of 155,172 shares of common stock at an exercise price of \$2.90 per share for a period of five years exercisable after nine months, subject to a termination condition as defined in the warrant. Simultaneously, the Company converted the short-term secured debt outstanding in the aggregate of approximately \$2.1 million inclusive of interest, together with \$72,962 of unsecured indebtedness, into 21,681 shares of Series C Mandatory Convertible Preferred Stock. As part of the condition for raising the equity financing, holders of a majority of the outstanding shares irrevocably undertook to effect a 1:20 reverse stock split of any outstanding shares of common stock. Under the terms of the \$4.5 million Preferred Stock Equity Financing, the new equity investors and the debt holders who converted their debt agreed to automatically convert their Preferred Stock into common shares, effective April 5, 2005, at a conversion price of \$2.90 per share and/or 2,299,345 shares of the Company's common stock (post reverse split), subject to adjustment in certain circumstances, see Note 11 to the accompanying financial statements.

The net cash proceeds from the equity financing will provide the funds necessary to expand our business as well as meeting our needs to satisfy specific outstanding obligations and accrued expenses. Specifically, the funds will be used to increase our marketing effort both in the US and overseas markets. The availability of this working capital will also permit us to build inventory to fulfill both current and future needs arising from our increased marketing efforts. The net proceeds from these placements should fulfill our capital needs through March 31, 2006, based upon our present business plan. In addition, as we start to build a meaningful penetration in the US market, we will need to expand our customer service and technical support capabilities to

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meet the needs of our clients. Similarly, in overseas markets, resources will be required to obtain regulatory approvals in markets where we believe there exists great opportunities for our business. We may also use our resources to develop further versions of our SteriMed System if it is determined that there is a market for such a product.

We had for the past several years met our need for capital in our various businesses through loans from officers, directors and related parties other than the monies received from the sale of the TDM business, which were primarily used to finance the acquired MCM business on December 17, 2002. We may require additional working capital or other funds, in the near future should we

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modify our current business plan or undertake any acquisitions.

### CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. On an on-going basis, management evaluates our estimates and assumptions, including but not limited to those related to revenue recognition and the impairment of long-lived assets, goodwill and other intangible assets. Management bases its estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

#### 1. Revenue recognition

The infectious medical waste business recognizes revenues from either the sale or rental of our SteriMed Systems. Revenues for sales are recognized at the time that the unit is shipped to the customer. Rental revenues are recognized based upon either services provided for each month of activity or evenly over the year in the event that a fixed rental agreement is in place.

#### 2. Goodwill and other intangibles

Goodwill and other intangibles associated with the MCM acquisition will be subject to an annual assessment for impairment by applying a fair-value based test. The valuation will be based upon estimates of future income of the reporting unit and estimates of the market value of the unit.

### ITEM 3. CONTROLS & PROCEDURES

Our principal executive officer and principal financial officer, based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-14 (c) and 15d-14 (c) of the Securities Exchange Act of 1934) as of March 31, 2005, have concluded that our disclosure controls and procedures are adequate and effective to ensure that material information relating to us and our consolidated subsidiaries are recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, particularly during the period in which this quarterly report has been prepared.

Our principal executive officer and principal financial officer have concluded that there were no significant changes in our internal controls or in other factors that could significantly affect these controls for the quarter ended March 31, 2005, the date of their most recent evaluation of such controls, and that there were no significant deficiencies or material weaknesses in our internal controls.

### PART II: OTHER INFORMATION

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

References made to the Form 8-K filed for an event of February 15, 2005 to report the issuance of an aggregate of 66,681 shares of Series C Mandatory Convertible Preferred Stock and associated warrants to purchase shares of common stock.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- (a) Exhibits
- 31.1\* Rule 13a-14(a)/15d-14(a) Certification
- 31.2\* Rule 13a-14(a)/15d-14(a) Certification
- 32\* Section 1350 - Certification
- \* filed herewith

(b) Reports on Form 8-K:

On April 5, 2005, we filed a current report on Form 8-K to report an event of April 5, 2005 in Item 8.01, whereby we amended our Certificate of Incorporation to provide for a one-for-twenty reverse split of our outstanding Common Stock. Upon the effective date, post split shares Common Stock began trading on the OTC Bulletin Board under the symbol of CAPS.

On February 18, 2005, we filed a current report on Form 8-K to report an event of February 15, 2005 in item 3.02 whereby we completed a \$4.5 million equity financing. The placement consisted of the sale of 45,000 shares of newly-created Series C Preferred Stock together with warrants to a group of investors. As a condition of the financing, we proposed a reverse stock split of 1:20 to facilitate the number of shares outstanding.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Caprius, Inc.  
(Registrant)

Date: May 11, 2005

/s/ George Aaron

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George Aaron  
President & Chief Executive Officer

Date: May 11, 2005

/s/ Jonathan Joels

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Jonathan Joels  
Chief Financial Officer

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