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INNOVATIVE MEDICAL SERVICES  
Form 10QSB/A  
August 13, 2001

U.S. Securities and Exchange Commission  
Washington, D.C. 20549

FORM 10-QSB/A

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934 For the period ended January 31, 2001  
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TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934 [No Fee Required] For the transition period from \_\_\_ to \_\_\_

Commission File number 0-21019  
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INNOVATIVE MEDICAL SERVICES  
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(Name of small business issuer in its charter)

California  
-----

33-0530289  
-----

(State or other jurisdiction of  
incorporation or organization)

(IRS Employer Identification No.)

1725 Gillespie Way, El Cajon, California 92020  
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(Address of principal executive offices)

619 596 8600  
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Issuer's telephone number

Check whether the issuer (1) filed all reports 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

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date: 6,625,752 as of March 16, 2001.

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EXPLANATORY NOTE ON AMENDMENT

The Registrant has filed this Amendment in response to comments received from the staff of the U.S. Securities and Exchange Commission. The Amendment has revised the following sections:

Financial Statements  
Notes to Financial Statements  
Management's Discussion and Analysis of Financial Condition and Results  
of Operations  
Exhibits  
Signatures

INNOVATIVE MEDICAL SERVICES

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PART 1. FINANCIAL INFORMATION

- Item 1. Financial Statements
  - Balance Sheets as of July 31, 2000 and January 31, 2001
  - Statements of Operations for the three months ended  
January 31, 2000 and 2001
  - Statements of Cash Flows for the three months ended  
January 31, 2000 and 2001
- Item 2. Management's Discussion and Analysis of Financial Condition  
and Results of Operations

PART 2. OTHER INFORMATION

- Item 1. Legal Proceedings
- Item 2. Changes in Securities
- Item 3. Defaults Upon Senior Securities: None
- Item 4. Submission of Matters to a Vote of Security Holders: None
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- Signatures

The interim financial statements include all adjustments which in the opinion of management are necessary in order to make the financial statements not misleading.

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS

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(Unaudited)	
January 31	July 31
2001	2000
Restated	Restated

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ASSETS	(Note 6)	(Note 6)
	-----	-----
Current Assets		
Cash and cash equivalents	\$ 348,578	\$ 1,121,316
Restricted cash	211,004	204,887
Accounts receivable, net of allowance for doubtful accounts of \$ 225,000 at January 2001 and \$225,000 at July 31, 2000	285,574	411,322
Due from officers and employees	335,624	226,729
Inventories	892,937	796,136
Prepaid expenses	63,842	33,975
	-----	-----
Total current assets	2,137,559	2,794,365
	-----	-----
Property, Plant and Equipment		
Property, plant and equipment	966,892	1,056,252
	-----	-----
Total property, plant and equipment	966,892	1,056,252
	-----	-----
Noncurrent Assets		
Deposits	8,127	14,083
Patents and license	803,009	300,910
Deferred acquisition costs	--	202,542
	-----	-----
Total noncurrent assets	811,137	517,535
	-----	-----
Total assets	\$ 3,915,587	\$ 4,368,152
	=====	=====
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	\$ 319,321	\$ 308,812
Accrued liabilities	46,867	36,880
Notes payable	196,009	210,592
	-----	-----
Total current liabilities	562,196	556,284
	-----	-----
Minority interest payable	--	61,697
	-----	-----
Stockholders' Equity		
Class A common stock, no par value: authorized 20,000,000 shares, issued and outstanding 6,504,351 at January 31, 2001 and 5,942,903 at July 31, 2000	10,556,543	10,018,873
Class A warrants: issued and outstanding 3,686,000 warrants	108,750	108,750
Accumulated deficit	(7,311,901)	(6,377,452)
	-----	-----
Total stockholders' equity	3,353,391	3,750,171
	-----	-----

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Total liabilities and stockholders' equity	\$ 3,915,587 =====	\$ 4,368,152 =====
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CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

	For the Six Months Ended January 31		For the Three Months January 31	
	2001	2000	2001	2000
Net sales	\$ 761,441	\$ 1,216,995	\$ 395,315	\$ 315,000
Cost of sales	424,517	575,053	260,440	160,000
	-----	-----	-----	-----
Gross profit	336,924	641,942	134,874	145,000
	-----	-----	-----	-----
Selling expenses	277,166	258,430	102,647	140,000
General and administrative expenses	939,493	571,262	492,565	320,000
Research and development	82,803	44,116	31,818	-
	-----	-----	-----	-----
Total operating costs	1,299,461	909,323	628,485	490,000
	-----	-----	-----	-----
Operating income (loss)	(962,537)	(267,380)	(493,611)	(345,000)
	-----	-----	-----	-----
Other income and (expense):				
Interest income	23,161	2,504	8,562	-
Interest Expense	(9,645)	(35,514)	(1,455)	(1,000)
	-----	-----	-----	-----
Total other income (expense)	13,516	(33,010)	7,107	(1,000)
	-----	-----	-----	-----
Income (loss) before income taxes, minority Interest in subsidiary operations and change in accounting principle	(949,021)	(264,876)	(494,693)	(346,000)
	-----	-----	-----	-----
Federal and state income taxes	400	400	200	-
	-----	-----	-----	-----
Income (loss) before minority interest in subsidiary operations and change in accounting principl	(949,421)	(265,276)	(494,893)	(346,000)
	-----	-----	-----	-----
Minority interest in subsidiary operations	14,972	310	0	-
	-----	-----	-----	-----
Net income (loss) before cumulative change in accounting principle	(934,449)	(264,966)	(494,893)	(346,000)
	-----	-----	-----	-----
Cumulative effect of change				

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in accounting principle	-	79,896	-	79
	-----	-----	-----	---
Net income (loss)	\$ (934,449)	\$ (185,070)	\$ (494,893)	\$ (26
	=====	=====	=====	=====
Net income (loss) per common share before change in accounting principle (basic)	\$ (0.15)	\$ (0.06)	\$ (0.08)	\$
Cumulative effect of change in accounting principle	-	0.02	-	-
	-----	-----	-----	---
Net income (loss) per common share (basic)	\$ (0.15)	\$ (0.04)	\$ (0.08)	\$
	=====	=====	=====	=====
Net income (loss) per common share before change in accounting principal (diluted)	\$ (0.15)	\$ (0.03)	\$ (0.08)	\$
Cumulative effect of change in accounting principle	-	0.01	-	-
	-----	-----	-----	---
Net income (loss) per common share (diluted)	\$ (0.15)	\$ (0.02)	\$ (0.08)	\$
	=====	=====	=====	=====

	Six Months Ended January 31 2001	Year Ended July 31 2000
CONSOLIDATED STATEMENTS OF ACCUMULATED DEFICITS		
-----		
Balance, beginning of period	\$ (6,377,452)	\$ (3,840,610)
Net income (loss)	(934,449)	(2,536,842)
	-----	-----
Balance, end of period	\$ (7,311,901)	\$ (6,377,452)
	=====	=====

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	For the Six Months En January 31	
	2001	2000
	-----	-----
Cash flows from operating activities		
Net income (loss)	\$ (934,449)	\$ (185,07
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization	43,099	-
Depreciation	95,370	72,32
Minority interest in subsidiary operations	(61,697)	101,49
Changes in assets and liabilities:		

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(Increase) decrease in restricted cash	(6,117)	1,96
(Increase) decrease in accounts receivable	125,748	(95,24)
(Increase) decrease in due from officers and employees	(108,895)	(97,15)
(Increase) decrease in prepaid expense	(29,867)	(13,24)
(Increase) decrease in inventory	(96,801)	3,17
(Increase) decrease in deposits	5,956	(6,50)
(Increase) decrease in goodwill	--	3,26
(Increase) decrease in intangible assets	--	4,50
Increase (decrease) in accounts payable	10,509	(89,12)
Increase (decrease) in accrued liabilities	9,987	(33,46)
	-----	-----
Net cash provided (used) by operating activities	(947,157)	(333,09)
	-----	-----
Cash flows from investing activities		
Purchase of patents and licenses	(299,558)	(68,40)
Purchase of property, plant and equipment	(49,109)	(292,23)
	-----	-----
Net cash (used) in investing activities	(348,667)	(360,63)
	-----	-----
Cash flows from financing activities		
Proceeds from debt obligations	--	121,30
Payments on debt obligations	(14,583)	(141,82)
Proceeds from sale of common stock	537,669	771,77
	-----	-----
Net cash provided by financing activities	523,086	751,24
	-----	-----
Net increase (decrease) in cash and cash equivalents	(772,738)	57,51
Cash at beginning of period	1,121,316	22,05
	-----	-----
Cash at end of period	\$ 348,578	\$ 79,57
	=====	=====
Supplemental disclosures of cash flow information		
Cash paid for interest paid	\$ 9,645	\$ 35,51
Cash paid for taxes paid	\$ 800	\$ 80
Noncash investing and financing activities:		
Value of shares issued in exchange for		
Nutripure.com minority interest	\$ 550,011	\$ --
Value of shares issued in exchange for ETI H2O	\$ 140,953	

NOTES TO FINANCIAL STATEMENTS

Note 1. Financial Statements

The financial statements included herein have been prepared by Innovative Medical Services (the Company) without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with generally accepted

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accounting principles have been condensed or omitted as allowed by such rules and regulations, and Innovative Medical Services believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the July 31, 2000 audited financial statements and the accompanying notes thereto. While management believes the procedures followed in preparing these financial statements are reasonable, the accuracy of the amounts are in some respects dependent upon the facts that will exist and procedures that will be accomplished by Innovative Medical Services later in the year. The results of operations for the interim periods are not necessarily indicative of the results of operations for the full year.

### Note 2. Stock Dividend

On October 26, 2000 Innovative Medical Services announced that the Board of Directors voted to declare a dividend in kind of Innovative Medical Services' common stock. This common stock dividend was declared and distributed in lieu of the previously announced dividend of Nutripure.com shares. The Company distributed one share of Innovative Medical Services' common stock for every fifty shares held of record on November 6, 2000, with fractional shares rounded up to the nearest whole share, for a total of 121,961 shares.

In December 1999, Innovative Medical Services formed a wholly owned subsidiary, Nutripure.com, to capitalize on internet commerce opportunities focusing on health and wellness. In January 2000, Innovative Medical Services declared a dividend in kind of Nutripure.com common stock as the Company began the process to spin off Nutripure.com as a separate public company. The record date and distribution date were to be set following completion of the registration of Nutripure.com as a reporting issuer with the Securities and Exchange Commission. During the last several months, however, adverse market conditions for solely internet-based ventures have eroded Management's confidence in the viability of a public market for Nutripure.com common stock. Therefore, the Board has amended its declaration of a Nutripure.com dividend to a dividend of Innovative Medical Services' common stock. The Company will retain Nutripure.com as an operating division of Innovative Medical Services in order to minimize the substantial administrative expense associated with launching and operating a public company.

### Note 3. Acquisitions

In November 2000, Innovative Medical Services acquired 100% of the stock of ETIH20, Inc., a Florida corporation, for 56,381 shares of IMS stock valued at \$140,953 (\$2.50 per share). The transaction was recorded using the purchase method of accounting. The assets acquired and liabilities assumed are as follows:

#### Assets:

Notes Receivable	\$ 33,655
Inventories	32,077
Equipment	16,932
Licensing & Distribution Rights	118,324
	-----
Total Assets	200,988

#### Liabilities:

Notes Payable - IMS	60,035
	-----

Equity	\$ 140,953
	=====

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Assets and liabilities were valued at historical cost and no goodwill was recorded in the transaction. Results of operations of ETIH20 Inc. are included in the current quarter. The acquired entity was a startup company, if results of operations were included in prior periods and shown as though the companies had been combined at the beginning of the period, it would not have a material affect on the consolidated financial statements of Innovative Medical Services.

The Company merged ETIH20 with a newly formed Nevada corporation of similar name and dissolved the Florida corporation. ETI-H20, a privately held technology corporation, developed Axenohl and focuses on research and development of varied water treatment applications, including electronic RF scale control, copper/silver ionization and filtration technologies.

### Note 4. Common Stock

In addition to the common stock issued, described in Notes 2 and 3, the Company completed a \$250,000 private placement in January 2001 in which the Company issued 83,334 shares of common stock to six investors at \$3.00 per Unit. Each Unit contained one share of common stock and a warrant to acquire an additional share of common stock for \$4.00 per share up to January 28, 2003.

### Note 5. Business Segment and Sales Concentrations

The Company operates in a single operating segment and is engaged in the development, manufacturing and marketing of water purification and dispensing equipment and related filter sales to independent pharmacies and large chain drug stores. Although the Company has expanded from its niche pharmacy market into other, broader markets with new products, including residential and commercial water filtration systems, health and wellness-related retail merchandise, e-commerce products, and silver ion bioscience technologies, at the January 31, 2001 revenues from these future segments were not material to the consolidated financial statements and no disaggregated information was reviewed.

Significant customers consisted primarily of domestic retail chain pharmacies. Sales concentrations to major chain stores were approximately \$175,900 and \$448,200, respectively, for the three months and the six months ended January 31, 2001. No customer accounted for more than 10% of consolidated sales in 2000 or 2001. Export sales were \$26,200 for the quarter and \$41,300 for the six months ended January 31, 2001.

### Note 6. Prior Period Adjustment - Write Down of Impaired Assets

The balance sheets have been adjusted to reflect the write-down of impaired assets in the fourth quarter of 2000. Ampromed was purchased in October of 1998 to enable the Company to take advantage of the lucrative markets for medical and dental supplies in Brazil and other South American countries and to later introduce and distribute its water purification products to these markets. Since the acquisition the economic conditions in the region have declined and implementation of the project has been delayed. The Company made its last sale in the region in October of 1999 and in May of 2000 terminated its lease in Rio de Janeiro and did not replenish the Ampromed inventory. The Company no longer has immediate plans to import medical and dental supplies into Brazil but believes, however, that Ampromed is a vital part of its plan to market and sell "Axenohl", RoachX and the Nutripure line of water treatment products. The Company believes there is considerable value in owning a Brazilian Limitada but has



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reassessed the value of the goodwill the customer list it purchased. Statement of Financial Accounting Standards No. 121 (Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of) requires an entity to review long-lived assets and identifiable intangible assets when, among other factors, there is a change in the extent or manner in which an asset is to be used or when there is a significant change in the business climate that could affect the value of an asset. The statement requires an entity estimate the future cash flows expected to result from the use of the asset and to recognize an impairment loss when the sum of the future cash flows is less than the carrying amount of the asset. Because of the unique nature of the products to be introduced, the Company does not believe it has enough quantifiable historical information to reliably predict future cash flows from this operation. For this reason the Company believes the Goodwill and Customer List should be written off, and the value of the Limitada license to do business in Brazil should be written down to what it would cost to acquire in today's market. This is estimated to be approximately \$150,000 which will be amortized over its expected useful life of 15 years. The total reduction of assets from this restatement was \$791,411. Because the effect of the write-down on the statements of operations presented was only a \$1,400 they have not been restated. Instead the adjustment will be made in the fourth quarter of 2001.

### ITEM 2

#### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the audited and unaudited financial statements of the Company.

#### OVERVIEW

Innovative Medical Services (the Company) began as a provider of pharmaceutical water purification products. The Company has expanded from its niche pharmacy market into other, broader markets with new products, including residential and commercial water filtration systems, health and wellness-related retail merchandise, e-commerce products, and silver ion bioscience technologies.

The Fillmaster(R) pharmaceutical water purification, dispensing and measuring products include the Pharmapure(R) water purification system, the FMD 550 dispenser, the patented Fillmaster 1000e computerized dispenser and the patented Scanmaster(TM) bar code reader. The Company also markets proprietary NSF certified replacement filters for the Fillmaster Systems.

The Company's Nutripure(R) line of water treatment and filtration systems includes the Nutripure 3000S-Series whole-house water softening systems, the Nutripure Elite reverse osmosis point-of-use systems, the Nutripure 2000 countertop water filtration system and the Nutripure Sport filtered sport bottle. The Company distributes its various Nutripure products in several ways, including retail sales, catalogue placement, business-to-business sales, internet promotion and in-home sales presentations.

During the first half of fiscal 2001, Innovative Medical Services created the Nutripure dealer program, a comprehensive sales and marketing program for the water treatment industry. The program offers existing independent water treatment dealers a line of residential water softening and other point-of-use water treatment equipment for sale to the public under IMS' Nutripure brand. In

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addition, the program provides complementary, industry-unique financing that extends credit to consumers for the purchase of water treatment equipment. During the second quarter, the Company partnered with Automated Payment Services ("APS"), and MBNA to strengthen and streamline the financing program and administration of the Nutripure dealer program. Under the unique Nutripure program, independent water treatment dealers may now offer credit to all prospective customers because the Nutripure programs offers competitive, risk-based interest rates. In addition, through APS, dealers can obtain real-time processing and approval information online for their customers. The dealer base for the program grows steadily, and the Company expects revenues from the Nutripure dealer program to accelerate in the second half of the year.

The Company, through its subsidiary Nutripure.com(R), operates an e-commerce health website, Nutripure.com, as a distributor of Bergen Brunswig products, which provides consumers a wide variety of vitamins, minerals, nutritional supplements, homeopathic remedies and natural products. In addition to merchandise, the website offers comprehensive health and wellness information in an easy-to-access, intuitive reference format.

Innovative Medical Services has obtained worldwide manufacturing and marketing rights for advanced silver ion technologies. Axenohl(TM) is an antimicrobial technology that uses the biocidal properties of ionic silver to kill bacteria viruses and fungi. Axenohl's broad effectiveness works to prevent and treat infection, and, unlike traditional disinfectants, Axenohl is non-toxic and environmentally friendly. Potential applications for products containing Axenohl include municipal and point-of-use/point-of-entry water treatment, food processing, personal disinfecting retail products, and commercial and retail hard surface disinfecting products. In addition, this technology may provide applications in the healthcare market for treatment of disease, including human and animal infections and wounds, and for disinfecting applications in hospitals, clinics, surgical centers, dental offices and other medical and health related facilities.

The disinfection efficacy of Axenohl has been well documented by independent testing laboratories. Axenohl eliminates the following test organism strains all within one minute and with 99.9999% efficacy (complete kill): Pseudomonas aeruginosa ATCC 15422, Staphylococcus aureus ATCC 6538, Salmonella cholerasuis ATCC 10708, E. Coli ATCC 0157:H7, Listeria monocytogenes ATCC 11543, Entrococcus facium ATCC 11543, Rhino virus (common colds), and Rotavirus (infectious diarrhea).

In March 2001, the US Patent and Trademark Office issued US Patent Number 6,197,814 for Axenohl. Patent applications have been filed in more than 50 countries and regions, and the World Intellectual Property Organization published the Axenohl International Patent Application on April 22, 1999 under publication number WO 99/18790.

Regulatory approval is a threshold event for the Company's commercial launch of Axenohl and related products in the United States. EPA approval of Axenohl for use as a hard surface disinfectant is believed imminent. Meanwhile, the Company has applied for approvals in several other countries. Axenohl is approved in Costa Rica for use as a water treatment chemical, hard surface disinfectant, and industrial disinfectant for direct food contact. Approval in Costa Rica for human and veterinary topical use is expected this quarter.

In March 2001, the Company signed its first significant contract for Axenohl with a Korean cosmetics company. Dodo & Company is launching a revolutionary line of acne-fighting cosmetics containing Axen as its active ingredient. (Axen(TM) is the trade name for the use dilution Axenohl solution.) Under the terms of the contract, Dodo & Company will purchase approximately \$1.2 million dollars of product from Innovative Medical Services over five years. In addition to the purchase price, Innovative Medical Services will receive a royalty on

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sales of the Axen-containing products. The Company anticipates that total revenues from the contract should exceed \$5 Million over five years. Dodo & Company plans to begin purchasing product in May 2001 in preparation for the September launch of its new product line. The company expects to begin realizing revenues from sales of Axenohl to additional international customers in the third fiscal quarter of 2001.

In January 2001, the Company acquired a new, pesticide technology. The EPA-approved RoachX(R) will be the first product to launch from the line. RoachX is over 96% effective in three to four days with one application for indoor and outdoor eradication of cockroaches, and can be used near children and food preparation areas. The patent-pending time-released formulation protects the boric acid from dissolving in water and maintains the integrity of the pesticide to obtain maximum killing effect. The product line, containing particular formulas for specific pests, provides excellent results against cockroaches, ants, palmetto bugs, silverfish, waterbugs, ticks, fleas, lice and garden pests.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JANUARY 31, 2001 VERSUS THREE MONTHS ENDED JANUARY 31, 2000 Total revenues of \$395,300 in the first quarter ended January 31, 2001 were 27% higher than the \$312,100 in revenues reported for the same quarter ended January 31, 2000. Fillmaster Purification System sales in the 2001 quarter were \$298,900 and replacement filter sales were \$77,800. In the 2000 quarter, Fillmaster Purification System sales were \$234,600 and replacement filter sales were \$74,000.

Gross profit in the most recent quarter was \$134,900 versus \$147,300 in the year-earlier quarter. The gross profit of 34% in 2001 was lower versus the 47% gross profit in 2000.

Net loss for the quarter ended January 31, 2001 was \$494,900 versus a loss of \$263,800 for the same quarter in 2000.

In November 2000, Innovative Medical Services acquired 100% of the stock of ETIH2O, Inc., a Florida corporation, for approximately 56,400 shares of IMS stock valued at approximately \$141,000. The transaction was recorded using the purchase method of accounting. The Company merged ETIH2O with a newly formed Nevada corporation of similar name and dissolved the Florida corporation. ETI-H2O, a privately held technology corporation, developed Axenohl and previously manufactured the product in cooperation with NVID. ETI-H2O specializes in research and development of varied water treatment applications, including electronic RF scale control, copper/silver ionization and filtration technologies.

During the second quarter, the Company partnered with Automated Payment Services ("APS"), and MBNA to strengthen and streamline the financing program and administration of the Nutripure dealer program. Under the unique Nutripure program, independent water treatment dealers may now offer credit to all prospective customers because the Nutripure programs offers competitive, risk-based interest rates. In addition, through APS, dealers can obtain real-time processing and approval information online for their customers. Revenues from the Nutripure water treatment dealer program continue to ramp up. The dealer base grows steadily, and Management believes that the program will accelerate through the second half of the year.

In addition to the ongoing expansion of the water dealer program, distribution of the Company's other products in the Water Treatment Division continued to grow in the second quarter. The Nutripure Sport Bottle was shipped to 900 GNC stores. Shaws Supermarkets has stocked the Nutripure Sport Bottle and the Nutripure 2000 and also will be installing Fillmaster Systems in the coming quarter. In March, Kaiser Permanente began purchasing Fillmaster pharmaceutical water filtration systems for all California pharmacies. Wal-Mart has placed Nutripure 2000 countertop water filtration systems in over 350 of its highest

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volume stores. CVS currently purchases Fillmaster systems for its new and remodeled stores at a rate of at least 50 units per month and plans to continue the roll out through the end of the calendar year. Nutripure Sport Bottle, Nutripure 2000 and Fillmaster are also being tested in Canada, with initial placement in some Pharma Plus and Wal-Mart Canada Stores. The Company expects retail product distribution to continue to increase in the second half of the fiscal year.

As mentioned in the Company Overview, regulatory approval is a threshold event for the Company's commercial launch of Axenohl and related products in the United States. EPA approval of Axenohl for use as a hard surface disinfectant is believed imminent, and if approvals are received, Management expects revenues from Axenohl to rapidly and substantially develop. Meanwhile, the Company has applied for international approvals in several countries. Axenohl is approved in Costa Rica for use as a water treatment chemical, hard surface disinfectant, and industrial disinfectant for direct food contact. Approval in Costa Rica for human and veterinary topical use is expected this quarter.

In March 2001, Innovative Medical Services signed a five-year contract with Dodo & Company, a leading Korean cosmetics manufacturer and marketer to provide Axenohl. Dodo & Company is launching a revolutionary line of acne-fighting cosmetics containing Axen as its active ingredient. (Axen is the trade name for the use-dilution Axenohl solution.) Under the terms of the contract, Dodo & Company will purchase approximately \$1.2 million dollars of product from Innovative Medical Services over five years. In addition to the purchase price, Innovative Medical Services will receive a royalty on sales of the Axen-containing products. The Company anticipates that, over the five years, the revenues from the cosmetics royalties will exceed the revenues from sales of Axen.

In January 2001, the Company announced its acquisition of a new, non-toxic pesticide technology. RoachX is the first product to launch, and since January, the Company has been working to increase distribution to commercial applicators and retailers. Major distribution projects are underway in the United States, Canada, Mexico, Germany, the United Kingdom, Korea, China and South Africa. The Company expects revenues from sales of RoachX to accelerate in the coming quarter and have a very significant short and long-term impact on revenues and earnings.

### RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JANUARY 31, 2001 VERSUS SIX MONTHS ENDED JANUARY 31, 2000

Revenues of \$761,400 in the six months ended January 31, 2001 were 37% lower than the \$1,217,000 in revenues reported for the six months ended January 31, 2000. Fillmaster Purification System sales in the six months ended January 31, 2001 were \$483,100 and replacement filter sales were \$199,600. In the prior period, Fillmaster Purification System sales were \$843,000 and replacement filter sales were \$266,000. Sales of Fillmaster Purification System decreased 23% and sales of filter replacements decreased 36% during the fiscal quarter 2000/2001. Management believes the decline in Fillmaster revenues is due to multiple factors, including the fact that the market for pharmacy products is maturing in that there is a decreasing number of pharmacy chains that do not have water filtration products, and that the Company has sold systems to most major chains. The focus for further Fillmaster sales will be on incremental and upgrade sales to individual pharmacies within current chain accounts, although the Company is still actively pursuing Fillmaster sales to remaining chains. Management expects to close such volume sales to new chains in the coming year, and, as in prior years, those sales will result in spikes in Fillmaster revenues. The Company works to retain customers with its Customer Service Plan 2000, a multi-year service and warranty contract.

Gross profits for the six months ended January 31, 2001 were \$336,900 versus \$641,900 in 2000. The gross profit of 44% in 2001 was lower versus the 53% gross

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profit in 2000. The decrease in gross profit percentage was largely due to fixed production and labor costs being applied to the unexpected lower sales volume for the year.

Net loss for first six months ended January 31, 2001 was \$934,400 versus \$185,100 for the same period last year. The decreased income was due to decreased sales and to an increase in General and Administrative expenses as the Company positions for anticipated rapid growth activity related to new ventures, including expanded retail distribution of the Nutripure 2000 home water system, Nutripure.com. and the new silver ion technologies. General and Administrative expenses increased \$368,200 from \$571,300 in fiscal 2000 to \$939,500 in fiscal 2001, \$137,600 of these expenses were related to Nutripure.com, a wholly owned subsidiary incorporated in the state of Nevada in December 1999. Nutripure.com is an e-commerce web supersite providing consumers a wide variety of vitamins, minerals, nutritional supplements, homeopathic remedies and natural products. In addition to products, the website offers comprehensive health and wellness information in an easy-to-access, intuitive reference format. The website also presents the Nutripure line of water filtration systems.

Throughout the six-month period, Innovative Medical Services focused its resources on expanding the current and future scope of business and related growth potential. The Company's increased selling expenses and general and administrative expenses reflect the Company's transition from a niche market company that provides water purification equipment to pharmacies to an international company containing several divisions to manage new products and programs in consumer and commercial water treatment, direct-to-consumer e-commerce and retail distribution of multiple product lines.

### LIQUIDITY AND CAPITAL RESOURCES

During the six months ended January 31, 2000, the Company's current assets to liabilities ratio decreased from 5.02 to 3.80. Current assets decreased \$658,700 from \$2,794,400 to \$2,135,700. The change in current assets during the six months ended January 31, 2001 include a decrease of \$772,700 in cash on hand, an increase in inventories of \$94,900, while total receivables remained constant during the period. Current liabilities also remained virtually constant during the six months ended January 31, 2001.

Cash flows used from operations were \$947,200 in the first six months of fiscal year 2001. Cash flows used from operations were \$333,100 for the same period in 2000. For those periods, cash flows used in investing activities included, respectively, \$49,100 and \$292,200 for the purchase of fixed assets and \$299,600 and \$68,400 for the purchase of patents and licenses. Cash flows from financing activities were decreased by payments on debt obligation of \$14,600 and increased by \$537,100 from the sale of common stock, which included a \$250,000 private placement in January 2001 in which the Company issued 83,334 shares of common stock to six investors at \$3.00 per Unit. Each Unit contained one share of common stock and a warrant to acquire an additional share of common stock for \$4.00 per share up to 5:00 p.m. Pacific time, January 28, 2003. Also, In November 2000, Innovative Medical Services acquired 100% of the stock of ETIH20, Inc., a Florida corporation, for approximately 56,400 shares of IMS stock valued at approximately \$141,000. The transaction was recorded using the purchase method of accounting. In addition, approximately \$132,700 was received from exercise of outstanding stock options.

The total decrease in cash and cash equivalents for the 2001 six-month period was \$772,700 as compared to increase of \$57,500 during the same period in 2000.

### PART 2 OTHER INFORMATION

#### ITEM 1

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### LEGAL PROCEEDINGS

The following is an update of developments in the previously disclosed litigation involving the Company filed in the Circuit Court of Pinellas County, Florida by Zedburn Corporation, against the Company for breach of contract in October 1997. The Company has filed counterclaims based upon the Racketeer Influenced and Corrupt Organization (RICO) Act against Mr. David Reitz, Zedburn Corporation, Capital Development Group, Steven Durland and other defendants. It is the Company's position that Mr. Reitz and others perpetrated a scheme to defraud the Company of cash fees and securities in connection with purported services of arranging a public offering of the Company's common stock. In October 1997, Mr. Reitz and Zedburn filed for protection under the Federal bankruptcy laws. In August 1998, Mr. Reitz voluntarily dismissed his bankruptcy and as a result thereof the Company has named Mr. Reitz as a defendant to its counterclaims.

The Company believes that the defendants had perpetrated similar schemes against other parties. The Company also believes it has substantially completed discovery and compiled compelling evidence to prove its claims.

Several of the Defendants filed Motions to Dismiss the Company's counterclaims. A hearing on the Motions was held on October 1, 1998. Certain of the Motions were granted pending the Company's amendment of its Counterclaim. The Company amended its Counterclaims in accordance with the judge's rulings. Certain Defendants filed second Motions to Dismiss the amended Counterclaims. A hearing on these latest motions was held in March 1999, before a different judge than the judge who ruled on the first motions. On April 20, 1999, Orders were entered granting the Defendants' Motions to Dismiss. However these Orders did not state the basis for the Orders, nor was the Company's legal counsel provided notice of the Orders or a copy of the new judge's correspondence offering a "formal ruling" upon request. In May 1999 the Company filed an Appeal of the Orders and Motions for Reconsideration based upon inconsistency of the Orders with the previous judge's rulings and the lack of notice to the Company. The Company believes that its Appeal and Motions have merit and will be granted. In any event the Company intends to pursue a trial as soon as possible. As of March 16, 2001, no ruling has been received on the Company's Appeal.

The Company has neither accrued a liability in its financial statements regarding this litigation nor disclosed the matter in the footnotes thereof. The Company has not done so because it does not believe there is any merit to Mr. Reitz's claims and that the likelihood that the Company will realize a loss from these matters is believed remote. In addition, the Company believes that in the unlikely event that the Company settles, the amount of any such settlement would not be material to the Company's financial statements.

The Company has filed an action against John Woodard, former Vice President of Sales, in Superior Court in the State of California in April 2000. The Company has alleged Mr. Woodard violated his non-competition/non-disclosure agreement and provided proprietary information, including information regarding the Company's Fillmaster line of products and Fillmaster customer base, to Fresh Water Systems, Inc. The Company has alleged the misappropriation of customer lists, equipment service and maintenance schedules, equipment data, business plans and research and development secrets. The Company is seeking monetary damages and injunctive relief. On November 20, 2000 an "Amendment to Complaint" was filed adding Lisa Still as a new Defendant. The Company alleges the same causes of actions to Lisa Still as previously alleged against Mr. Woodard.

The Company has also filed an action against Fresh Water Systems, Inc., Steven Norvell, Brian Folk and Eric Norvell in Superior Court in the State of California. The action was filed in August 2000 and amended in October 2000. The Company alleges Fresh Water Systems and its officers and directors misappropriated trade secrets of the Company obtained from former employees of the Company, engaged in unfair competition in violation of the California Unfair

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Practices Act, tortious interference with contractual relations, tortious interference with prospective business advantage, fraud, trade libel and conspiracy with regard to the Fillmaster line of products and Fillmaster customer base. The Company is seeking monetary damages and injunctive relief. On or about October 20, 2000 a motion for Consolidation was granted by the Superior Court, thereby merging the Fresh Water Systems lawsuit into the Woodard lawsuit. A jury trial date was set in the above matters for January 2002. Numerous discovery issues propounded to defendants are still awaiting responses.

The Company filed an action against Eckerd Corporation in Superior Court in the State of California in August 2000. The Company alleges Eckerd Corporation has not paid for Fillmaster products ordered by and shipped to Eckerd pharmacies. The Company seeks monetary damages not less than \$170,000 plus interest and attorney's fees. In September 2000, Defendant filed a "Notice of Removal" moving said case from California Superior Court to the Federal Court for the Southern District of California. Minimal discovery commenced regarding Eckerd's contacts with California. Defendants then filed a motion to "Dismiss for Lack of Personal Jurisdiction." On March 5, 2001 this motion was granted dismissing said action. The Company plans to appeal this motion and/or file this action in the state of Florida.

### ITEM 2.

#### CHANGES IN SECURITIES

In January 2001, the Company issued 83,334 shares of common stock to six investors in a private placement at \$3.00 per Unit. Each unit contained one share of common stock and a warrant to acquire an additional share of common stock for \$4.00 per share up to 5:00 p.m. Pacific time, January 28, 2003.

With respect to the sales made, the Company relied on Section 4(2) of the Securities Act of 1933, as amended. No advertising or general solicitation was employed in offering the securities. The securities were offered solely to accredited or sophisticated investors who were provided all of the current public information available on the Company.

Also in February 2001, the Company issued 20,000 shares of common stock to a single investor in settlement of a debt of ETI H2O, Inc.

With respect to these shares, the Company relied on Section 3(a)(10) of the Securities Act of 1933, as amended as the shares were a security issued in exchange for a bona fide outstanding claim where the terms and conditions of such issuance and exchange have been approved, after a hearing by a court of the United States.

### ITEM 3.

#### DEFAULTS UPON SENIOR SECURITIES

Not applicable.

### ITEM 4.

#### SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On January 8, 2001 the Registrant held its annual meeting of shareholders in San Diego, California. The following Directors of the Registrant were reelected to the Board of Directors by the votes as follows:

Nominee	Votes For	Votes Withheld	Abstentions/Broker Non-Votes
Dennis Brovarone	5,093,587	13,832	0
Gary Brownell	5,093,587	13,832	0

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Patrick Galuska	5,093,629	13,790	0
Michael L. Krall	5,093,587	13,832	0
Eugene Peiser	5,093,629	13,790	0
Donna Singer	5,093,629	13,790	0

The only other item of business at the meeting was approval of the Innovative Medical Services 2001 Officers Directors Stock Option Plan. The plan was approved by the following vote:

Votes For	Votes Against	Abstentions	Broker Non-Votes
922,944	93,831	14,300	4,076,344

ITEM 5.  
OTHER INFORMATION  
Not applicable.

ITEM 6.  
EXHIBITS AND REPORTS ON FORM 8-K

(A)	EXHIBITS
	10.4 -- Weaver - Roach X Assignment dated January 4, 2001
	EXHIBITS DESCRIPTION
	11 Statement re: computation of per share earnings
(B)	REPORTS ON FORM 8-K
	None

SIGNATURES

Pursuant to the requirement 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.

INNOVATIVE MEDICAL SERVICES  
(Registrant)

By: /s/ Michael L. Krall  
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Michael L. Krall, President/CEO  
August 13, 2001

By: /s/ Gary Brownell  
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Gary Brownell, Chief Financial Officer  
August 13, 2001