

SPO Medical Inc  
Form 10-K  
April 05, 2012

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

**MARK ONE:**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**  
x

for the Fiscal Year ended December 31, 2011

..TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

*COMMISSION FILE NUMBER: 0-11772*

**SPO MEDICAL INC.**

(Name of registrant as specified in its charter)

Delaware 11-3223672  
(State or Other Jurisdiction of Incorporation) (IRS Employer Identification No.)

3, Gavish Street, POB 2454, **Kfar Saba, Israel**

(Address of Principal Executive Offices)

**9-966-2520**

(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Exchange Act: None

Securities Registered Pursuant to Section 12(g) of the Exchange Act: \$0.01 par value common stock

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.  
☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐

Smaller Reporting  
Company ☒

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

The registrant had 41,779,650 shares of common stock outstanding as of April 5, 2012. The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant, computed by reference to the closing price of such common stock on the over the counter Bulletin Board on June 30, 2011, was approximately \$4.7 million.

**SPO MEDICAL INC.**

**2011 FORM 10-K ANNUAL REPORT**

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## FORWARD LOOKING STATEMENTS

THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH THE FINANCIAL STATEMENTS AND RELATED NOTES CONTAINED ELSEWHERE IN THIS FORM 10-K. CERTAIN STATEMENTS MADE IN THIS DISCUSSION ARE "FORWARD-LOOKING STATEMENTS" WITHIN THE MEANING OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. FORWARD-LOOKING STATEMENTS CAN BE IDENTIFIED BY TERMINOLOGY SUCH AS "MAY," "WILL," "SHOULD," "EXPECTS," "INTENDS," "ANTICIPATES," "BELIEVES," "ESTIMATES," "PREDICTS," OR "CONTINUE" OR THE NEGATIVE OF THESE TERMS OR OTHER COMPARABLE TERMINOLOGY AND INCLUDE, WITHOUT LIMITATION, STATEMENTS BELOW REGARDING: THE COMPANY'S INTENDED BUSINESS PLANS; EXPECTATIONS AS TO PRODUCT PERFORMANCE; EXPECTATIONS AS TO MARKET ACCEPTANCE OF THE COMPANY'S TECHNOLOGY; AND BELIEF AS TO THE SUFFICIENCY OF CASH RESERVES. BECAUSE FORWARD-LOOKING STATEMENTS INVOLVE RISKS AND UNCERTAINTIES, THERE ARE IMPORTANT FACTORS THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE EXPRESSED OR IMPLIED BY THESE FORWARD-LOOKING STATEMENTS. THESE FACTORS INCLUDE, BUT ARE NOT LIMITED TO, THE COMPANY'S ABILITY TO OBTAIN NECESSARY FINANCING; SUFFICIENCY OF CASH RESERVES; SUCCESS OF RESTRUCTURED OPERATIONS; GOING CONCERN QUALIFICATIONS; THE COMPETITIVE ENVIRONMENT GENERALLY AND IN THE COMPANY'S SPECIFIC MARKET AREAS; CHANGES IN TECHNOLOGY; THE AVAILABILITY OF AND THE TERMS OF FINANCING; INFLATION; CHANGES IN COSTS AND AVAILABILITY OF GOODS AND SERVICES; ECONOMIC CONDITIONS IN GENERAL AND IN THE COMPANY'S SPECIFIC MARKET AREAS; DEMOGRAPHIC CHANGES; CHANGES IN FEDERAL, STATE AND /OR LOCAL GOVERNMENT LAW AND REGULATIONS AFFECTING THE TECHNOLOGY; CHANGES IN OPERATING STRATEGY OR DEVELOPMENT PLANS; AND THE ABILITY TO ATTRACT AND RETAIN QUALIFIED PERSONNEL. ALTHOUGH THE COMPANY BELIEVES THAT EXPECTATIONS REFLECTED IN THE FORWARD-LOOKING STATEMENTS ARE REASONABLE, IT CANNOT GUARANTEE FUTURE RESULTS, PERFORMANCE OR ACHIEVEMENTS. MOREOVER, NEITHER THE COMPANY NOR ANY OTHER PERSON ASSUMES RESPONSIBILITY FOR THE ACCURACY AND COMPLETENESS OF THESE FORWARD-LOOKING STATEMENTS. THE COMPANY IS UNDER NO DUTY TO UPDATE ANY FORWARD-LOOKING STATEMENTS AFTER THE DATE OF THIS REPORT TO CONFORM SUCH STATEMENTS TO ACTUAL RESULTS.

## **PART I**

### **ITEM 1. BUSINESS**

#### **Overview**

SPO Medical Inc. (“we” or the “Company”) is engaged in the design, development and marketing of non-invasive pulse oximetry technologies to measure blood oxygen saturation and heart rate. We have developed and patented proprietary technology that enables the measurement of heart rate and oxygen saturation levels in the blood, which is known as Reflectance Pulse Oximetry (RPO). Using RPO, a sensor can be positioned on various body parts, hence minimizing problems from motion artifacts and poor perfusion. The unique design features contribute to substantially lower power requirements and enhance wireless, stand-alone configurations facilitating expanded commercial possibilities. As of March 2012, we hold 12 patents issued by the United States Patent and Trademark Office (“USPTO”) covering various aspects of our technologies. As further discussed below, our technologies are currently applied to products that are designed for use by in the homecare, professional medical care, sports, safety and search and rescue markets.

In January 2010, our wholly owned subsidiary SPO Ltd. (“Ltd”) entered into an Alliance and License Agreement dated as of December 1, 2009 with an entity owned and controlled by our Chief Technical Officer (the “Licensee”). Under the terms of the license agreement, the PulseOx medical product line discussed in further detail is being marketed by the Licensee in the medical field. Under the license agreement, all worldwide sales, marketing and all existing inventory and manufacturing of the PulseOx line in the medical field was transferred to the Licensee in consideration of \$200,000 in cash and the Licensee’s (and its affiliates) agreement to pay to Ltd royalties derived from these products in agreed upon amounts.

Following the license agreement, we are primarily engaged in developing and licensing our technology to third parties for integration with products in the recreational, baby wellness and sports monitoring fields. We have ceased all operating activities formerly conducted with respect to the manufacture and marketing of our PulseOx medical product line to the medical market and we intend to pursue joint ventures, OEM type arrangements, research and or subcontracting agreements relating to our oximetry technology with respect to the recreational, baby wellness and sports monitoring fields.

We need to raise additional funds on an immediate basis in order to meet our on-going operating requirements, pay outstanding loans in the aggregate approximate amount of \$1,246,000 and to realize our restructured business plan. In response to the deteriorating global economic conditions that began in 2008, we have taken certain measures in an effort to reduce operating expenses and conserve our cash resources. As of April 5, 2012, we had two employees working on a full-time basis. We intend to pursue joint ventures, OEM type arrangements, research and or sub

contractor agreements relating to our oximetry technology with respect to the recreational, baby wellness and sports monitoring fields. If we are unable to generate cash flow through a joint-venture or similar type of agreement or raise capital, it may be necessary for us to cease operations entirely. No assurance can be given that we will be able to raise the needed capital. These conditions raise substantial doubt about our ability to continue as a going concern.

## **Background**

Pulse oximetry is an important non-invasive process used both to measure blood oxygen saturation levels (SpO<sub>2</sub>) by monitoring the percentage of hemoglobin that is saturated with oxygen and to measure heart rate. This procedure has been used regularly in hospitals during the past twenty years and is established as an essential measurement in medical practice to ensure maintenance of adequate oxygen and prevention of respiratory difficulty. In many disease states, oxygen saturation is one of the most important vital signs to monitor.

There are two methods to measure pulse oximetry by transmission through a body part or by reflection. In general, the transmission method can only be used on certain areas of the body, such as fingers, earlobes, etc. Furthermore, in some instances when the transmission method is used, physiological conditions such as stress and temperature can adversely affect the accuracy of pulse oximetry readings.

Since pulse oximetry measurements taken on-site in an emergency, at local medical practices, and/or in home care can save lives and curtail intervention costs, mobile units have been developed. However, mobile oximetry units have not been widely adopted because their power requirements (and hence limited battery life) often make them impractical. In addition, existing mobile units require patients to remain absolutely stationary to produce reliable results, further reducing their practicality.

### **Our solution**

Responding to the need for life-saving information in the field where people cannot be absolutely stationary, we have developed patented sensors that work accurately during mild physical activity. This technique uses a reflectance method (known as RPO) whereby a very small sensor placed on the body at various locations has the ability to measure oxygen saturation and heart pulse rate. We have incorporated our patented reflectance technology into portable devices for medical and consumer applications. Moreover, these devices operate at a power requirement approximately 1/50th of that compared to other commercially available portable systems. This puts pulse oximetry into the hands medical practitioners and emergency personnel on-site for the safety and benefit of all and offers the opportunity to create new commercial and consumer applications.

We intend to continue to leverage our core technologies to develop new, innovative product applications for the recreational, baby wellness and sports monitoring markets. In furtherance of this goal, we intend to pursue joint ventures, OEM type arrangements, and research and or sub contractor agreements relating to our oximetry technology with respect to these fields.

### **Products**

The following details commercially available products that utilize our unique pulse oximetry technology.

PulseOx 5500TM — a stand-alone commercial RPO spot check monitor for SpO2 and heart rate. The PulseOx 5500TM uses SPO patented technology to provide a medical device that is easier to use for many patients and less expensive to operate than any other device that is commercially available. Its main advantages include: (i) long lasting battery with

more than 1,000 hours, using only a fraction of the power used by competitive devices and (ii) resistance to many forms of motion, reducing its susceptibility to the motion artifacts that are typical of other pulse oximetry devices. The PulseOx 5500 was first introduced commercially during the fourth quarter of 2004. The device was approved and registered by the Food and Drug Administration ("FDA") in June 2004. The device also carries the CE (European Directives 93/42/EEC and 90/385/EEC for regulatory and safety standards of medical equipment) and Canadian Standards Association (CSA) mark for safety and audited manufacturing processes, all of which were obtained in February 2005.

Check Mate™— addresses the sports and aviation market's demand for a lightweight, inexpensive monitor for measuring SpO<sub>2</sub> and heart rate during physically active and high-altitude activities. It offers the user a greater ability to monitor these vital signs under motion and is less expensive than most other available devices. The Check Mate was first introduced commercially during third quarter of 2005. The Check Mate does not require FDA approval or registration. It carries the CE and CSA mark for safety and audited manufacturing processes.

PulseOx 7500™ —a monitor for extended monitoring of SpO<sub>2</sub> and heart rate by means of RPO. The monitor is being initially marketed for pre screening of sleep apnea sufferers. Its main advantages include: (i) long lasting battery equivalent to a month's use of monitoring using only a fraction of the power used by competitive devices and hence a lower cost of ownership and (ii) resistance to many forms of motion, reducing its susceptibility to the motion artifacts that are typical of other similar pulse oximetry devices.

PulseOx 6000 TM — a professional stand-alone commercial RPO spot check monitor for SpO<sub>2</sub> and heart rate. The PulseOx 6000TM uses our patented technology to provide a medical device which is easier to use for many patients and less expensive to operate than any other device that is commercially available. Its main advantages include: (i) long lasting battery with more than 500 hours, using only a fraction of the power used by competitive devices and (ii) Autospot™ technology which compensates for resistance to many forms of motion, thereby reducing its susceptibility to the motion artifacts that are typical of other pulse oximetry devices and low perfusion experienced in certain patients. The PulseOx 600TM was first introduced commercially during the first quarter of 2008. The device is approved and registered by the Food and Drug Administration ("FDA"). The device carries the CE and CSA mark for safety and audited manufacturing processes.

PulseOx 6100 TM — a professional stand-alone hand held commercial RPO spot check monitor for SpO<sub>2</sub> and heart rate. The PulseOx 6100TM uses our patented technology to provide a medical device that is easier to use for many patients and less expensive to operate than any other device that is commercially available. Its main advantages include: (i) long lasting battery with more than 200 hours, using only a fraction of the power used by competitive devices, (ii) Autospot™ technology which compensates for resistance to many forms of motion reducing its susceptibility to the motion artifacts that are typical of other pulse oximetry devices and low perfusion experienced in certain patients and (iii) flash memory for recording multiple patient readings. The PulseOx 6100TM was first introduced commercially during the first quarter of 2008. The device carries the CE and CSA mark for safety and audited manufacturing processes.

### **License Agreement Relating to the Above Product Lines**

In the license agreement that we entered into in January 2010, the Licensee was granted an exclusive, non transferable, royalty bearing license, in the Field of Use, subject to certain minimum annual payments discussed below, with respect to the PulseOx product line (including the CheckMate Product line) to (i) manufacture and distribute the PulseOx™ product line, including the Check Mate™ (collectively the "Special Products"), and derivatives, (ii) to use and improve our technology (whether or not related specifically to the Special Products) for purpose of creating derivative products based on the Special Products, (iii) bundle Special Products with licensee's technology (the "Bundled Technology"). The term "Field of Use" has been defined to mean medical technologies and products designed to measure any vital sign(s) which utilize reflective oximetry methodology, where "medical" has been limited to refer solely to any technology or product being targeted for sale solely for use by persons with a potential or existing illness and technology to determine whether a person is alive.

The license described above is exclusive with respect to Special Products and the Bundled Technology that measure pulse (by any means) and one other vital sign and non-exclusive with Special Products or the Bundled Technology that measure only pulse (with no other vital sign being measured).

In addition to the license rights described above, the Licensee was also granted an exclusive non-transferable, royalty bearing, world wide license to manufacture and distribute the Check Mate™ device, SPO LTD's specially designed monitor for measuring SpO2 and heart rate during physically active and high latitude activities.

Under the agreement, the Licensee (and its affiliates) have undertaken to pay to SPO LTD royalties derived from Special Products as follows (collectively, the "Royalties"):

- (i) With respect to 2011, 50% of net revenues in excess of \$600,000 per calendar quarter; and
- (ii) From 2012 through the end of the lease term, 6% of gross revenues.

As of Dec 31 2011, no royalty revenues payments were generated for SPO LTD by the Licensee.

With respect to Bundled Technology, from 2010 through the end of the term, under the Agreement the Licensee (and its affiliates) are to pay 3% of gross revenues, payable on a quarterly basis, so long as Special Products do not comprise more than 50% of Bundled Technology. If the Special Products constitute more than 50% of the Bundled Technology, the per annum royalty rate shall be at the rate of 6%. Royalties are payable within the later to occur of (i) the 30<sup>th</sup> day following receipt of revenues proceeds or (ii) 30<sup>th</sup> day following the end of the period for which royalties are payable.

In order to maintain the exclusive license rights described above, we are to receive, beginning 2013 and continuing through the end of the license period, per annum minimum royalties in the aggregate amount of at least \$60,000 (the “Minimum Royalty Payment”). The Minimum Royalty Payment is due by the 30<sup>th</sup> day following the end of the year. If for whatever reason the Minimum Royalty Payment is not paid when due, then the license shall automatically and without any further action become non-exclusive. We have the right to audit to review or audit the Licensee records to verify compliance with the terms of the Agreement.

Unless terminated earlier as provided therein, the license terms under the Agreement extends through November 30, 2016. Notwithstanding the foregoing, either party is entitled to terminate the Agreement (i) upon a material breach by the other party and its failure to cure such breach within 30 days following receipt of written notice thereof, (ii) upon the other party’s insolvency or liquidation event or (iii) if the results of three audits performed by us shall reveal that Licensee (or its affiliates) underreported by 10% the amount of payments due to the Company.

## **Research & Development / Products under Design and Development**

We currently have in various stages of development other wellness market devices utilizing our oximetry technology. These include the following:

**Baby Movement Monitor** — a monitor being designed specifically for the use with infants. This unique monitor is being designed for continual non-invasive monitoring of an infant particularly during the hours that the baby is sleeping.

**Sports Watch** — a sports watch for monitoring heart rate for sports enthusiast to monitor their wellness while training or engaging in sport activities without the requirement to wear a conventional chest strap or equivalent.

**Wellness Bracelet** — an easy-to-use bracelet that can be worn to continually measure number of activities and calories burned by an individual performs on a daily basis; this potential product offering could be marketed to the large

obesity market for adult and children alike. In December 2011, we signed an exclusive agreement with a large private time-piece manufacture to manufacture and sell the Company's innovative wellness bracelet to department stores, mid-tier mass-market and food & drug stores throughout North America. The agreement specifies that the manufacturer will finance all costs associated with bringing the wellness bracelet to the marketplace. We and the manufacturer have agreed to divide the profit margin from the sale of the wellness bracelet net of all costs associated with manufacturing the wellness. The term of the agreement continues through December 2013. All intellectual property rights are retained by us.

Our research and development activities as well as product design activities are primarily conducted on an outsourcing basis by our subsidiary SPO Ltd. located in Israel.

### **Business Strategy**

Our mission is to build a profitable business that develops and commercializes wellness products that improve people's lives and provide reassurance of wellness and thereby increase stockholder value. In January 2010, we completed a restructuring plan in an attempt to focus primarily on licensing our core technology for non-medical market applications. Going forward, we intend to operate primarily as a development and licensing entity.

To achieve our objectives, we are pursuing the following business strategies:

*Increasing growth potential by pursuing new market opportunities.* Through our initial success in penetrating the medical device market with our proprietary oximetry technology, we intend to diligently pursue other market opportunities that are seeking similar technological solutions and product offerings as previously demonstrated and implemented by us. These include the recreational, sports and wellness markets.

*Partner with highly qualified, focused companies, internationally.* We intend to continue to seek out collaborative arrangements with leading international distributors for our consumer products for which we have developed the prototypes, in preparation for technological due diligence. We have identified a number of potential partners for these products, although there can be no assurance that we will be able to enter into any such collaborative arrangement.

*Research and Development.* Subject to raising additional capital, our research and development strategy in the near future will focus on our consumer product lines to enable the Company to partner with client corporations for commercialization and distribution.

## **Suppliers**

We currently outsource part of our industrial design and associated prototyping activities. However, the outsourcing of these operations may mean that some degree of risks related to delivery schedules, yields, and other factors are not directly under our control.

## **Marketing and Sales Organization.**

Following the restructuring of our business operations in 2010, we are primarily engaged in managing research and development and design activities on an outsourcing basis as well as business development activities with potential client corporations for commercialization and distribution of our oximetry technology. We intend to pursue joint ventures, OEM type arrangement, research and or sub contractor agreements relating to our oximetry technology with respect to the recreational, baby wellness and sports monitoring fields. We anticipate that our prospective partners, if any, will take responsibility for manufacturing and sales/marketing of their products that incorporate the oximetry technology component from us.

## **Patents and Proprietary Information**

We currently rely on a combination of patent, trade secret, copyright and trademark law, as well as non-disclosure agreements and invention assignment agreements, to protect proprietary information. However, such methods may not afford complete protection and there can be no assurance that other competitors will not independently develop such processes, concepts, ideas and documentation. As of April 2012, we hold twelve patents issued by the United States Patent and Trademark Office ("USPTO") covering various aspects of our unique sensors for radiance based diagnostics using pulse oximetry. Although we believe that our existing issued patents provide a competitive advantage, there can be no assurance that the scope of our patent protection is or will be adequate to protect our technologies or that the validity of any patent issued will be upheld in the future.

Because of the uncertainty of patent protection and the unavailability of patent protection for certain processes and techniques, our policy is to require our employees, consultants, other advisors, as well as utility and design collaborators, to execute confidentiality and assignment of invention agreements upon the commencement of employment, consulting or advisory relationships. These agreements generally provide that all confidential information developed or made known to a party by us during the course of the party's association with the Company is to be kept confidential and not to be disclosed to third parties except in specific circumstances. In the case of employees and consultants, the agreements also provide that all inventions conceived by the individual in the course of their employment or consulting relationship will be our exclusive property.

## **Employees**

As of April 5, 2012, we had two employees working on a full time basis. None of these employees are subject to collective bargaining agreements.

## **Competition**

We believe that most of the companies that possess oximetry technology are currently offering solutions exclusively in the medical or related market applications. We are not aware of specific entities that have a similar strategy as implemented by the Company to target sports, baby monitoring and general wellness markets with their oximetry technology or resultant product offerings. We further believe that the reflective oximetry nature of the Company's technology is a limiting factor for other entities to operate in non-medical or related market applications.

There are number of companies, some of which are substantially larger than we are and with significantly more resources, that are engaged in manufacturing competing products specifically in the medical market. Our competitors include Nonin Medical Inc. of Plymouth, Minnesota, a privately owned company; and Smiths Medical PM Inc. of Waukesha, WI, which is the designer, manufacturer, and distributor of the BCI(R) brand of patient monitoring equipment which competes with our products.

Within the last few years several Chinese based medical device manufacturers extended their share of the homecare medical market and have become direct competitors to a number of our medical products. Their pricing models have significantly impacted this market and in particular under the current economic conditions being experienced across world wide markets.

## **Governmental Regulations**

The manufacture and sale of the PulseOx products by the Licensee are subject to extensive regulation by numerous governmental authorities, principally by the FDA and corresponding foreign agencies. The FDA administers the Federal Food, Drug and Cosmetic Act and the regulations promulgated thereunder. The PulseOx 5500TM, PulseOx 60000TM, PulseOx 6100TM and PulseOx 7500TM are sold in the United States and are subject to the FDA's standards and procedures for the manufacture of medical devices and our facilities are subject to inspection by the FDA for compliance with such standards and procedures.

The FDA classifies each medical device into one of three classes depending on the degree of risk associated with the device and the extent of control needed to ensure safety and effectiveness. Our medical products have been classified by the FDA as Class II device and have secured a 510(k) pre-market notification clearance before being introduced into the United States market. For additional products, the process of obtaining 510(k) clearance typically takes several months and may involve the submission of limited clinical data supporting assertions that the product is substantially equivalent to an already approved device or to a device that was on the market before the enactment of the Medical Device Amendments of 1976.

Every company that manufactures or assembles medical devices to be sold in the United States is required to register with the FDA and adhere to certain "good manufacturing practices" in accordance with the FDA's Quality System Regulation which regulates the manufacture of medical devices, prescribes record keeping procedures and provides for the routine inspection of facilities for compliance with such regulations. The FDA also has broad regulatory powers in the areas of clinical testing, marketing and advertising of medical devices.

Medical device manufacturers are routinely subject to periodic inspections by the FDA. If the FDA believes that a company may not be operating in compliance with applicable laws and regulations, it can:

place the company under observation and re-inspect the facilities; or issue a warning letter apprising of violating conduct;

detain or seize products;

mandate a recall;

enjoin future violations; and

assess civil and criminal penalties against the company, its officers or its employees.

We are also subject to regulation in each of the foreign countries in which we sell our products. Many of the regulations applicable to our products in such countries are similar to those of the FDA. The national health or social security organizations of certain countries require our products to be qualified before they can be marketed in those countries.

## AVAILABLE INFORMATION

Our Internet websites are located at <http://www.spoglobal.com> and [www.spowellness.com](http://www.spowellness.com). This reference to our Internet websites do not constitute incorporation by reference in this report of the information contained on or hyperlinked from our Internet website and such information should not be considered part of this report.

The public may read and copy any materials we file with the Securities and Exchange Commission ("SEC") at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Rooms by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet website that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. The SEC's Internet website is located at <http://www.sec.gov>.

## ITEM 1A. RISK FACTORS

The following risk factors should be considered carefully in addition to the other information presented in this report. This report contains forward-looking statements that involve risks and uncertainties. Our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, the following:

## RISKS RELATED TO OUR BUSINESS

**WE NEED ADDITIONAL FINANCING ON AN ACUTE BASIS AND FAILURE TO OBTAIN ADEQUATE FINANCING COULD LEAD TO THE FINANCIAL AND OPERATING FAILURE OF OUR COMPANY.**

We believe that our existing cash resources are insufficient to enable us to maintain operations as presently conducted and meet our obligations as they come due, as well pay outstanding loans which are currently due and payable. We will not be able to maintain operations as presently conducted beyond June 30, 2012 unless we raise additional funds or generate fees, whether through the issuance of our securities, licensing fees for our technology or otherwise. If we are unsuccessful in these efforts, we may consequently have to cease operations entirely. Without adequate funding, we also may not be able to accelerate the development and deployment of our products, respond to competitive pressures and develop new or enhanced products. At the present time, we have no commitments for any financing, and there can be no assurance that capital will be available to us on commercially acceptable terms or at all. We may have difficulty obtaining additional funds as and when needed, and we may have to accept terms that would adversely affect our stockholders. Any failure to achieve adequate funding will delay our development programs and product launches and could lead to abandonment of one or more of our development initiatives, as well as prevent us from responding to competitive pressures or take advantage of unanticipated acquisition opportunities. In addition to a number of outstanding amounts owed to suppliers and professional service providers, as at December 31, 2011 we owe approximately \$1,246,000 on outstanding notes that we issued in April 2005, July 2006, December 2010, May 2011 and November 2011. We currently do not have the capital resources from which to pay these amounts.

Any additional equity financing may be dilutive to stockholders, and debt and certain types of equity financing, if available, may involve restrictive covenants or other provisions that would limit how we conduct our business or finance our operations.

Even if we raise funds to address our immediate working capital requirements, we also may be required to seek additional financing in the future to respond to increased expenses or shortfalls in anticipated revenues, accelerate product development and deployment, respond to competitive pressures, develop new or enhanced products, or take advantage of unanticipated acquisition opportunities. In addition, the deterioration in the general economic environment that began in 2008 and continued into 2011 further complicates our capital raising efforts.

These conditions raise substantial doubt as to our ability to continue as a going concern and may make it more difficult for us to raise additional capital when needed. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability of reported assets or liabilities should we be unable to continue as a going concern.

**WE HAVE A HISTORY OF LOSSES AND EXPECT TO INCUR LOSSES AND NEGATIVE OPERATING CASH FLOWS IN THE FUTURE.**

Our accumulated deficit was approximately \$20.1 million as at December 31, 2011. We expect our operating losses to continue as we continue to expend resources to further develop and enhance our technology offering, to complete prototyping for proof-of-concept, obtain regulatory clearances or approvals as required, expand our business development activities and finance capabilities and conduct further research and development. We also expect to experience negative cash flow in the short-term until licensing revenues become available through the implementation of the Company's technology via client corporations for commercialization and distribution of products that include our technology.

**WE DO NOT HAVE A LONG OPERATING HISTORY, WHICH MAKES IT DIFFICULT FOR YOU TO EVALUATE OUR BUSINESS.**

SPO Ltd. commenced operations in 1998. We introduced our first product into the marketplace in the fourth quarter of 2004. Accordingly, there is limited historical information regarding our revenue trends and operations upon which investors can evaluate our business. Our prospects must be considered in light of the substantial risks, expenses, uncertainties and difficulties encountered by entrants into the medical device industry, which is characterized by increasing intense competition and the relative failure rates.

**THE SALE OF OUR PRODUCTS IN THE UNITED STATES IS SUBJECT TO GOVERNMENT REGULATIONS AND WE MAY NOT BE ABLE TO OBTAIN CERTAIN NECESSARY CLEARANCES OR APPROVALS.**

The design, manufacturing, labeling, distribution and marketing of medical device products in the United States is subject to extensive and rigorous regulation by the Food and Drug Administration (FDA). In order for us to market our products in the United States, we must obtain clearance or approval from the FDA which can be expensive and uncertain and can cause lengthy delays before we can begin selling our products. We cannot be sure:

- that we, or any collaborative partner, will make timely filings with the FDA;
- that the FDA will act favorably or quickly on these submissions;
- that we will not be required to submit additional information or perform additional clinical studies;

that we would not be required to submit an application for pre-market approval, rather than a 510(k) pre-market notification submission as described below; or

- that other significant difficulties and costs will not be encountered to obtain FDA clearance or approval.

The FDA may impose strict labeling or other requirements as a condition of its clearance or approval, any of which could limit our ability to market our products. Further, if we wish to modify a product after FDA clearance of a pre-market notification or approval of a pre-market approval application, including changes in indications or other modifications that could affect safety and efficacy, additional clearances or approvals will be required from the FDA. Any request by the FDA for additional data, or any requirement by the FDA that we conduct additional clinical studies or submit to the more rigorous and lengthier pre-market approval process, could result in a significant delay in bringing our products to market and substantial additional research and other expenditures. Similarly, any labeling or other conditions or restrictions imposed by the FDA on the marketing of our products could hinder our ability to effectively market our products. Any of the above actions by the FDA could delay or prevent altogether our ability to market and distribute our products. Further, there may be new FDA policies or changes in FDA policies that could be adverse to us.

**OUTSIDE THE UNITED STATES, WE ARE SUBJECT TO GOVERNMENT REGULATION, WHICH COULD DELAY OR PREVENT OUR ABILITY TO SELL OUR PRODUCTS IN CERTAIN JURISDICTIONS.**

In order for us to market our products in Europe and some other international jurisdictions, we and our distributors and agents must obtain required regulatory registrations or approvals. We must also comply with extensive regulations regarding safety, efficacy and quality in those jurisdictions. We may not be able to obtain the required regulatory registrations or approvals, or we may be required to incur significant costs in obtaining or maintaining any regulatory registrations or approvals we receive. Delays in obtaining any registrations or approvals required to market our products, failure to receive these registrations or approvals, or future loss of previously obtained registrations or approvals would limit our ability to sell our products internationally. For example, international regulatory bodies have adopted various regulations governing product standards, packaging requirements, labeling requirements, import restrictions, tariff regulations, duties and tax requirements. These regulations vary from country to country.

**EVEN IF WE OBTAIN CLEARANCE OR APPROVAL TO SELL OUR PRODUCTS, WE ARE SUBJECT TO ONGOING REQUIREMENTS AND INSPECTIONS THAT COULD LEAD TO THE RESTRICTION, SUSPENSION OR REVOCATION OF OUR CLEARANCE.**

We are required to adhere to applicable FDA regulations and ISO standards regarding good manufacturing practice, which include testing, control, and documentation requirements. We are subject to similar regulations in foreign countries. Ongoing compliance with good manufacturing practice and other applicable regulatory requirements will be

strictly enforced in the United States through periodic inspections by state and federal agencies, including the FDA, and in international jurisdictions by comparable Notified Body for CE Marking and ISO Standards. Failure to comply with these regulatory requirements could result in, among other things, warning letters, fines, injunctions, civil penalties, recall or seizure of products, total or partial suspension of production, failure to obtain premarket clearance or premarket approval for devices, withdrawal of approvals previously obtained, and criminal prosecution. The restriction, suspension or revocation of regulatory approvals or any other failure to comply with regulatory requirements would limit our ability to operate and could increase our costs.

**OUR SUCCESS LARGELY DEPENDS ON OUR ABILITY TO OBTAIN AND PROTECT THE PROPRIETARY INFORMATION ON WHICH WE BASE OUR PRODUCTS.**

Our success depends in large part upon our ability to establish and maintain the proprietary nature of our technology through the patent process, as well as our ability to license from others patents and patent applications necessary to develop our products. If any of our patents are successfully challenged, invalidated or circumvented, or our right or ability to manufacture our products was to be limited, our ability to continue to manufacture and market our products could be adversely affected.

The defense of patent infringement suits is costly and time-consuming and their outcome is uncertain. In addition, our limited financial resources may limit our ability to defend our granted patents, if challenged. An adverse determination in litigation could subject us to significant liabilities, require us to obtain licenses from third parties, or restrict or prevent us from selling our products in certain markets. Although patent and intellectual property disputes are often settled through licensing or similar arrangements, costs associated with such arrangements may be substantial and could include ongoing royalties. Furthermore, the necessary licenses may not be available to us on satisfactory terms, if at all. Thus, as discussed above, if third party patents cover any aspect of our products or processes, then we may lack freedom to operate in accordance with our business plan.

As of April 2012, we have been issued twelve United States patents. One or more of the patents for our existing or future products, may be successfully challenged, invalidated or circumvented, or we may otherwise be unable to rely on these patents. These risks are also present for the process we use or will use for manufacturing our products. In addition, our competitors, many of whom have substantial resources and have made substantial investments in competing technologies, may apply for and obtain patents that prevent, limit or interfere with our ability to make, use and sell our products, either in the United States or in international markets.

The medical device industry has been characterized by extensive litigation regarding patents and other intellectual property rights. In addition, the United States Patent and Trademark Office may institute interference proceedings. The defense and prosecution of intellectual property suits, Patent and Trademark Office proceedings and related legal and administrative proceedings are both costly and time consuming. Moreover, we may need to litigate to enforce our patents, to protect our trade secrets or know-how, or to determine the enforceability, scope and validity of the proprietary rights of others. Any litigation or interference proceedings involving us may require us to incur substantial legal and other fees and expenses and may require some of our employees to devote all or a substantial portion of their time to the proceedings. An adverse determination in the proceedings could subject us to significant liabilities to third parties, require us to seek licenses from third parties or prevent us from selling our products in some or all markets. We may not be able to reach a satisfactory settlement of any dispute by licensing necessary patents or other intellectual property. Even if we reached a settlement, the settlement process may be expensive and time consuming, and the terms of the settlement may require us to pay substantial royalties. An adverse determination in a judicial or administrative proceeding or the failure to obtain a necessary license could prevent us from manufacturing and selling our products.

In addition to patents, we rely on trade secrets and proprietary know-how, which we seek to protect, in part, through confidentiality and proprietary information agreements. The other parties to these agreements may breach these provisions, and we may not have adequate remedies for any breach. Additionally, our trade secrets could otherwise become known to or be independently developed by competitors.

**OUR PRODUCTS USE NOVEL TECHNOLOGIES OR APPLY TECHNOLOGIES IN MORE INNOVATIVE WAYS THAN OTHER COMPETING MEDICAL DEVICES AND ARE OR WILL BE NEW TO THE MARKET; ACCORDINGLY, WE MAY NOT BE SUCCESSFUL IN ACHIEVING WIDE ACCEPTANCE OF OUR PRODUCTS AND OUR OPERATIONS AND GROWTH WOULD BE ADVERSELY AFFECTED.**

Our technology offering is based on new methods of reflective pulse oximetry. If products that include our technology do not achieve significant market acceptance, our royalties from sales will be limited and our financial condition may suffer. To date, few independent studies regarding our technology have been published. The lack of independent studies limits the ability of potential OEM/licensing partners to compare products that include our technology within to conventional products.

**OUR LIMITED BUSINESS DEVELOPMENT AND MARKETING EXPERIENCE MAKES OUR REVENUE UNCERTAIN.**

We are responsible for business development and marketing our oximetry technology offering. We have relatively limited experience in business development and marketing and only have one internal person responsible for these tasks. In order to successfully continue to promote our technology offering, we must partner with client corporations for commercialization and distribution of products that include our technology. We may not be able to successfully reach agreements with client corporations for commercialization and distribution of products that include our technology. In addition, we compete with other companies that have experienced and well-funded marketing and sales operations. If we enter into a marketing arrangement with a third party, any revenues we would receive will be dependent on this third party, and we will likely be required to pay a sales commission or similar compensation to this party. The efforts of these third parties for the marketing and sale of products that include our technology within may not be successful.

**BECAUSE WE OPERATE IN AN INDUSTRY WITH SIGNIFICANT PRODUCT LIABILITY RISK, AND WE HAVE NOT SPECIFICALLY INSURED AGAINST THIS RISK, WE MAY BE SUBJECT TO SUBSTANTIAL CLAIMS AGAINST OUR PRODUCTS.**

Medical products entail significant risks of product liability claims. We currently have limited product liability insurance coverage beyond that provided by our general liability insurance. Accordingly, we may not be adequately protected from any liabilities, including any adverse judgments or settlements, we might incur in connection with the development, clinical testing, manufacture and sale of our products. A successful product liability claim or series of claims brought against us that result in an adverse judgment against or settlement by us in excess of any insurance coverage could seriously harm our financial condition or reputation. In addition, product liability insurance is expensive and may not be available to us on acceptable terms, if at all.

**THE AVAILABILITY OF THIRD-PARTY REIMBURSEMENT FOR OUR PRODUCTS VIA OUR LICENSEE IS UNCERTAIN, WHICH MAY LIMIT CONSUMER USE AND THE MARKET FOR OUR PRODUCTS.**

In the United States and elsewhere, sales of medical products are dependent, in part, on the ability of consumers of these products to obtain reimbursement for all or a portion of their cost from third-party payors, such as government and private insurance plans. Any inability of patients, hospitals, physicians and other users of products that include our technology to obtain sufficient reimbursement from third-party payors for our products, or adverse changes in relevant governmental policies or the policies of private third-party payors regarding reimbursement for these products, could limit the marketability of these products. We are unable to predict what changes will be made in the reimbursement methods used by third-party health care payors. Moreover, third-party payors are increasingly challenging the prices charged for medical products and services, and some health care providers are gradually

adopting a managed care system in which the providers contract to provide comprehensive health care services for a fixed cost per person. Patients, hospitals and physicians may not be able to justify the use of products that include our technology by the attendant cost savings and clinical benefits that we believe will be derived from the use of such products, and therefore may not be able to obtain third-party reimbursement.

Reimbursement and health care payment systems in international markets vary significantly by country and include both government sponsored health care and private insurance. Our Licensee may not be able to obtain approvals for reimbursement from these international third-party payors in a timely manner, if at all. Any failure to receive international reimbursement approvals could have an adverse effect on market acceptance of products that include our technology in the international markets in which approvals are sought.

**OUR SUCCESS DEPENDS ON OUR ABILITY TO ATTRACT AND RETAIN SCIENTIFIC, TECHNICAL, MANAGERIAL AND FINANCE PERSONNEL.**

Our ability to operate successfully and manage our future growth depends in significant part upon the continued service of key scientific, technical, managerial and finance personnel, as well as our ability to attract and retain additional highly qualified personnel in these fields. We may not be able to attract and retain key employees when necessary, which would limit our operations and growth. In addition, if we are able to successfully develop and commercialize our technology, we will need to hire additional scientific, technical, marketing, managerial and finance personnel. We face intense competition for qualified personnel in these areas, many of whom are often subject to competing employment offers.

**THERE IS NO ESTABLISHED MARKET FOR OUR COMMON STOCK AND NONE MAY DEVELOP OR BE SUSTAINED**

Since October 8 2007, our Common Stock has been quoted on the over-the-counter Bulletin Board under the symbol “SPOM”. The Bulletin Board is a centralized quotation service that collects and publishes market maker quotes in real time. Because our stock trades on the Bulletin Board, rather than on a national securities exchange this may affect the liquidity of our Common Stock. Prior to such date, our Common Stock was quoted on the “Pink Sheets”.

There has been very limited trading activity in our Common Stock. There can be no assurance that a more active or established trading market will commence in our securities. Further, in the event that an established trading market commences, there can be no assurance as to the level of any market price of our shares of common stock, whether any trading market will provide liquidity to investors, or whether any trading market will be sustained. Investors should be aware that our stock may be illiquid.

**FUTURE SALES OF COMMON STOCK OR OTHER DILUTIVE EVENTS MAY ADVERSELY AFFECT PREVAILING MARKET PRICES FOR OUR COMMON STOCK**

As of April 5, 2012, we had 100 million authorized shares of Common Stock, of which 41,779,650 shares of our Common Stock were issued and outstanding as of such date. An additional 21,326,124 shares have been reserved for issuance upon exercise or conversion of outstanding options, warrants and convertible securities. Many of the those options, warrants and convertible securities contain provisions that require the issuance of increased numbers of shares of common stock upon exercise or conversion in the event of stock splits, redemptions, mergers or other transactions. The occurrence of any such event or the exercise or conversion of any of the options, warrants or convertible securities described above would dilute the interest in our company represented by each share of Common Stock and may adversely affect the prevailing market price of our Common Stock.

Our board of directors has the authority, without further action or vote of our stockholders, to issue all or any part of the shares of our Common Stock that are authorized for issuance and neither issued nor reserved for issuance. Additionally, we require additional funds to continue to meet our liquidity needs and maintain our operations as presently conducted and to realize our business plan. Such stock issuances may be made at a price that reflects a discount from the then-current trading price of our Common Stock. In order to raise capital that we need at today's stock prices, we would likely need to issue securities that are convertible into or exercisable for a significant number of shares of our Common Stock.

The shares of Common Stock issuable upon conversion of our securities or the outstanding shares are saleable without restriction. Any of these issuances will dilute the percentage ownership interests of our current stockholders, which will have the effect of reducing their influence on matters on which our stockholders vote, and might dilute the book value and market value of our Common Stock. Our stockholders may incur additional dilution upon the exercise of currently outstanding or subsequently granted options or warrants to purchase shares of our Common Stock.

#### **OUR STOCK PRICE MAY BE VOLATILE.**

There is a very limited market for our stock. The market price of our common stock will likely fluctuate significantly in response to the following factors, some of which are beyond our control:

Variations in our quarterly operating results due to a number of factors, including but not limited to those identified in this "RISK FACTORS" section;

- Changes in financial estimates of our revenues and operating results by securities analysts or investors;

Announcements by us of commencement of, changes to, or cancellation of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;

- Additions or departures of key personnel;

- Stock market price and volume fluctuations attributable to inconsistent trading volume levels of our stock;

- Commencement of or involvement in litigation; and

- announcements by us or our competitors of technological innovations or new products

In addition, the equity markets have experienced volatility that has particularly affected the market prices of equity securities issued by high technology companies and that often has been unrelated or disproportionate to the operating results of those companies. These broad market fluctuations may adversely affect the market price of our Common Stock.

**ADDITIONAL BURDENS IMPOSED UPON BROKER-DEALERS BY THE APPLICATION OF THE "PENNY STOCK" RULES TO OUR COMMON STOCK MAY LIMIT THE MARKET FOR OUR COMMON STOCK.**

Broker-dealer practices in connection with transactions in "penny stocks" are regulated by certain penny stock rules adopted by the Securities and Exchange Commission. Penny stocks generally are equity securities with a price of less than \$5.00 (other than securities registered on certain national securities exchanges or quoted on the Nasdaq system, provided that current prices and volume information with respect to transactions in such securities are provided by the exchange or system). If our Common Stock continues to be offered at a market price less than \$5.00 per share, and does not qualify for any exemption from the penny stock regulations, our Common Stock will continue to be subject to these additional regulations relating to low-priced stocks.

The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document that provides information about penny stocks and the risks in

the penny stock market. The broker-dealer also must provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction, and monthly account statements showing the market value of each penny stock held in the customer's account. In addition, the penny stock rules generally require that prior to a transaction in a penny stock the broker-dealer make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. These requirements have historically resulted in reducing the level of trading activity in securities that become subject to the penny stock rules.

The additional burdens imposed upon broker-dealers by these penny stock requirements may discourage broker-dealers from effecting transactions in the Common Stock, which could severely limit the market liquidity of our Common Stock and our shareholders' ability to sell our Common Stock in the secondary market.

**OUR BOARD OF DIRECTORS' RIGHT TO AUTHORIZE THE ISSUANCE OF ADDITIONAL SHARES OF PREFERRED STOCK COULD ADVERSELY IMPACT THE RIGHTS OF HOLDERS OF OUR COMMON STOCK.**

Our board of directors currently has the right to designate and authorize the issuance of our preferred stock, in one or more series, with such voting, dividend and other rights as our directors may determine. The board of directors can designate new series of preferred stock without the approval of the holders of our Common Stock. The rights of holders of our Common Stock may be adversely affected by the rights of any holders of shares of preferred stock that may be issued in the future, including without limitation dilution of the equity ownership percentage of our holders of Common Stock and their voting power if we issue preferred stock with voting rights. Additionally, the issuance of preferred stock could make it more difficult for a third party to acquire a majority of our outstanding voting stock.

**RISKS RELATED TO OPERATIONS IN ISRAEL**

**WE DEPEND ON A SINGLE RESEARCH AND DEVELOPMENT FACILITY IN ISRAEL AND ARE SUSCEPTIBLE TO ANY EVENT THAT WOULD ADVERSELY AFFECT ITS CONDITION**

Most of our outsourced research and development facilities are located in the State of Israel. Fire, natural disaster or any other cause of material disruption in our operation in this location could have a material adverse effect on our business, financial condition and operating results. As discussed above, to remain competitive in the network communications industry, we must respond quickly to technological developments. Damage to our facility in Israel could cause serious delays in the development of new products and services and, therefore, could adversely affect our business. In addition, the particular risks relating to our location in Israel are described below.

**WE MAY BE ADVERSELY AFFECTED FROM FOREIGN CURRENCY MARKET FLUCTUATIONS.**

A significant portion of our expenses, primarily labor expenses and certain supplier contracts, are denominated in New Israeli Shekels "NIS". As a result, we have significant exposure to the risk of fluctuating exchange rates with the US Dollar, our primary reporting currency. The recent volatility in the international currency markets has been equally reflected against NIS and this may continue in the future. Owing to the lack of cash flow resources and financing, we are limited in our ability to hedge against currency fluctuations.

**THE TRANSFER AND USE OF SOME OF OUR TECHNOLOGY AND ITS PRODUCTION IS LIMITED BECAUSE OF THE RESEARCH AND DEVELOPMENT GRANTS WE RECEIVED FROM THE ISRAELI**

**GOVERNMENT TO DEVELOP SUCH TECHNOLOGY. SUCH LIMITATIONS MAY RESTRICT OUR BUSINESS GROWTH AND PROFITABILITY.**

Our research and development efforts associated with the development of oximetry products have been partially financed through grants from the Office of the Chief Scientist of the State of Israel (the "Chief Scientist"). We are subject to certain restrictions under the terms of the Chief Scientist grants. Specifically, the products developed with the funding provided by these grants may not be manufactured, nor may the technology which is embodied in our products be transferred outside of Israel without appropriate governmental approvals and/or fines. These restrictions do not apply to the sale or export from Israel of our products developed with this technology. These restrictions could limit or prevent our growth and profitability.

**DETERIORATION OF POLITICAL, ECONOMIC AND SECURITY CONDITIONS IN ISRAEL MAY ADVERSELY AFFECT OUR OPERATIONS.**

Any major hostilities involving Israel, a substantial decline in the prevailing regional security situation or the interruption or curtailment of trade between Israel and its present trading partners could have a material adverse effect on our operations. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Beginning in September 2000, the overall relationship and security situation between Israel and the Palestinians deteriorated significantly and continues to be marked by ongoing violence, also varying in its degree of severity. During the summer of 2006, Israel was engaged in an armed conflict with Hezbollah, a Lebanese Islamist Shiite militia group and political party; and during the winter of 2008-2009, Israel was engaged in an armed conflict with Hamas, a militia group and political party operating in the Gaza Strip. These conflicts involved missile strikes against civilian targets in various parts of. To date, these matters have not had any material effect on our business and results of operations, but there can be no assurance that they will not do so in the future.

In addition, civil unrest, often accompanied by violence, has spread throughout the region. Protestors have demanded economic and political reforms, and to date, there have been several regime changes in other countries. Civil unrest could continue to spread throughout the region or grow in intensity, leading to regime changes resulting in governments that are hostile to the US, civil wars, or regional conflict. There have also been rising international tensions over Iran, which was censured by the United Nations over suspicions that it is trying to develop nuclear weapons. Certain countries have considered actions ranging from economic sanctions to pre-emptive strikes on suspected nuclear sites, and Iranian officials have threatened retaliation by, among other actions, closing the Strait of Hormuz, through which a significant portion of the global crude oil supply is transported.

Prolonged and/or widespread regional conflict in the Middle East could have the following results, among others:

- Capital market reassessment of risk and subsequent redeployment of capital to more stable areas making it more difficult for us to obtain financing for potential development projects;

- security concerns in Israel, making it more difficult for our personnel or supplies to enter or exit the country;

- security concerns leading to evacuation of our personnel;

- inability of our service and equipment providers to deliver items necessary for us to conduct our operations in, resulting in delays; and

Loss of property and/or interruption of our business plans resulting from hostile acts could have a significant negative impact on our earnings and cash flow. In addition, we may not have enough insurance to cover any loss of property or other claims resulting from these risks.

#### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

#### **ITEM 2. PROPERTIES**

We do not own any real property.

We lease approximately 250 square feet in Kfar Saba, Israel which are the administrative offices for our subsidiary SPO Ltd. We paid \$2,520 for the use of the office space for each of the fiscal years 2011 and 2010.

In addition through February 2011, we leased approximately 1615 square feet in Kiryat Malachi, Israel which was used by SPO Ltd. for the research and development activities. We paid \$6,400 for the use of the office space for January and February of 2011.

We believe that our facilities are generally in good condition and suitable to carry on our business. We also believe that, if required, suitable alternative or additional space will be available to us on commercially reasonable terms.

### ITEM 3. LEGAL PROCEEDINGS

There are no material pending legal proceedings to which we are a party or to which any of our properties are subject. There are no material proceedings known to us to be contemplated by any governmental authority.

### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our Common Stock is quoted on the OTC Bulletin Board under the symbol "SPOM". Prior to such date, our Common Stock was quoted on the Pink Sheets LLC's Electronic Inter-dealer Quotation and Trading System under ticker symbol "SPOM". Trading of our Common Stock has been sporadic and limited. There can be no assurance that an established trading market will develop, that the current market will be maintained or that a liquid market for our Common Stock will be available in the future. Investors should not rely on historical stock price performance as an indication of future price performance.

The following table shows the quarterly high and low bid prices for our Common Stock over the last two completed fiscal years. The prices represent quotations by dealers without adjustments for retail mark-ups, mark-downs or commission and may not represent actual transactions.

|                              | LOW    | HIGH   |
|------------------------------|--------|--------|
| Year Ended December 31, 2011 |        |        |
| First Quarter                | \$0.05 | \$0.15 |
| Second Quarter               | \$0.01 | \$0.18 |
| Third Quarter                | \$0.01 | \$0.16 |
| Fourth Quarter               | \$0.01 | \$0.08 |

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Year Ended December 31, 2010

|                |        |        |
|----------------|--------|--------|
| First Quarter  | \$0.03 | \$0.32 |
| Second Quarter | \$0.20 | \$0.35 |
| Third Quarter  | \$0.11 | \$0.35 |
| Fourth Quarter | \$0.09 | \$0.25 |

As of April 5, 2012, there were approximately 163 holders of record of our Common Stock. We believe that a number of shares of our Common Stock are held in either nominee name or street name brokerage accounts and, consequently, we are unable to determine the exact number of beneficial owners of our stock.

### **DIVIDEND POLICY**

We have paid no dividends on our Common Stock and do not expect to pay cash dividends in the foreseeable future with respect to the Common Stock. It is the present policy of our board of directors to retain all earnings to provide funds for our growth. The declaration and payment of dividends in the future will be determined by our board based upon our earnings, financial condition, capital requirements and such other factors as our board may deem relevant. We are not under any contractual restriction as to our present or future ability to pay dividends.

## **RECENT SALES OF UNREGISTERED SECURITIES**

We sold no securities during the three months ended December 31, 2011:

## **ITEM 6. SELECTED FINANCIAL DATA**

Not Applicable.

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

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

### **OVERVIEW**

SPO Medical Inc. ("we" or the "Company" or "SPO") is engaged in the design and development of non-invasive pulse oximetry technologies to measure blood oxygen saturation and heart rate. We have developed and patented proprietary technology that enables the measurement of heart rate and oxygen saturation levels in the blood, which is known as Reflectance Pulse Oximetry (RPO). RPO functions using an ASIC (application specific integrated circuit), which is equivalent to a "customized" semi-conductor. Using this technology, a sensor can be positioned on various body parts, minimizing problems from motion artifacts and poor perfusion. The unique design features contribute to substantially lower power requirements and enhance wireless, stand-alone configurations facilitating expanded commercial possibilities. As of April 2012, we hold 12 patents issued by the United States Patent and Trademark Office ("USPTO") and European Patent Authorities covering various aspects of our technologies.

We are currently focused on exploiting the sports, baby monitoring and wellness markets by developing cutting edge products based on our proprietary technology. These are multibillion dollar markets which we intend to penetrate with our disruptive technologies. Our current wellness products under development include an innovative bracelet, a baby

monitoring unit and a sports watch.

The SPO sports watch has been designed to measure continuous hear-rate wirelessly, without the need to wear a conventional chest strap. This is a major and unique practical advantage over current products that we believe exist in the general leisure and wellness market. As importantly, the watch will be able to read the heart rate without the sports enthusiast ceasing his physical activity. This will be made possible through the use of SPO's patented reflectance technology. Subject to raising significant additional funds, of which no assurance can be provided, we anticipate that the product should become commercially available during 2013.

In addition to the sports watch, we are in the final stages of developing an innovative wellness bracelet that measures the number of activities and calories burned by an individual performs on a given day. The bracelet, designed for both children and adults, features a display function to continuously measure the number of daily activities against preset recommended goals. SPO has designed and patented the functionality of the bracelet to be an affordable, simple-to-use, fashion accessory to encourage users to increase their mobility and overall wellness and to wear it with pride. We anticipate that the product should become commercially available during the latter part of 2012. In December 2011, we signed an exclusive agreement with a large private time-piece manufacture to manufacture and sell the Company's innovative wellness bracelet to department stores, mid-tier mass-market and food & drug stores throughout North America. The agreement specifies that the manufacturer will finance all costs associated with bringing the wellness bracelet to the marketplace. We and the manufacturer have agreed to divide the profit margin from the sale of the wellness bracelet net of all costs associated with manufacturing the wellness.

In addition, we are developing an innovative home-baby monitoring device for continuous measurement of wellness information to the parent or caregiver, while the baby is sleeping. This parental reassurance tool gives the company a technological competitive edge in providing an innovative, high performance solution for a market application that is applicable to most family homes. Subject to raising significant additional funds, of which no assurance can be provided, we believe that the product could become commercially available during late 2013.

Although we currently focus on the sports, baby monitoring and wellness market, we have a legacy business that has been dedicated to the health care and medical products industry. In January 2010, our wholly owned subsidiary SPO Ltd. entered into an Alliance and License Agreement, dated as of December 1, 2009, with an entity owned and controlled by our Chief Technical Officer (the "Licensee"). Under the terms of the license agreement, the PulseOx medical product line is being marketed by the Licensee in the medical field.

We have generated significant operating losses since inception and we have a limited operating history upon which an evaluation of our prospects can be made. Our prospects must therefore be evaluated in light of the problems, expenses, delays and complications associated with a development stage company.

We need to raise additional funds on an immediate basis in order to realize our business plan as well as pay outstanding loans in the approximate amount of \$1,246,000, of which \$1,170,000 were currently due and payable at December 31, 2011, and to maintain operations. In response to the deteriorating global economic conditions that began in 2008, we have taken certain measures in an effort to reduce operating expenses and conserve our cash resources. Beginning July 2008, we have significantly curtailed our non-essential product design and development, and ceased all marketing activities and product manufacturing. We have terminated certain product development plans. In January 2010, we restructured our operations in an attempt to focus primarily on our core technology for non-medical market operations. The restructuring included entering into a licensing agreement for our then existing medical PulseOx product line, which resulted in the cessation of the Company's production, selling and marketing activities. As of April 5, 2012, we had two employees working on a full-time basis. In addition, all research and development activities are performed on a sub-contracted basis. If we are unable to raise capital on an immediate basis, it may be necessary for us to take further cost cutting measures to reduce our cash burn including laying-off additional personnel and/or cease operations entirely. No assurance can be given that we will be able to raise the needed capital. These conditions raise substantial doubt about our ability to continue as a going concern.

## **CRITICAL ACCOUNTING POLICIES**

The discussion and analysis of our financial condition and results of operations are based upon our audited consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue

recognition, bad debts, investments, intangible assets and income taxes. Our estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

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

## **REVENUE RECOGNITION**

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

## **USE OF ESTIMATES**

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

## **RESULTS OF OPERATIONS**

As noted above, in January 2010, we restructured our operations to focus primarily on licensing our core technology for non-medical market application. The restructuring included entering into a licensing agreement (the "License") for our then existing medical PulseOx product line. Under the terms of the License, the licensee was granted a non-transferable, royalty bearing license, to distribute the PulseOx product line and derivatives thereof, for specifically defined medical uses. Following the License, we ceased our previous operations associated with the distribution of the PulseOx line in the medical field. Following the License, we are primarily engaged in developing and licensing our technology to third parties for integration with products in the recreational, military and baby wellness monitoring fields. The cessation of operations was given effect as of January 1, 2009.

## **COMPARISON OF THE YEAR ENDED DECEMBER 31, 2011 (the "2011 Period") AND THE YEAR ENDED DECEMBER 31, 2010 (the "2010 Period")**

As noted above, in January 2010, we restructured our operations to focus primarily on licensing our core technology for non-medical market application. The restructuring included entering into a licensing agreement (the "License") for our then-existing medical PulseOx product line. Under the terms of the License, the licensee was granted a non-transferable, royalty bearing license, to distribute the PulseOx product line and derivatives thereof, for specifically defined medical uses. Following the License, we ceased our previous operations associated with the distribution of the PulseOx line in the medical field. Following the License, we are primarily engaged in developing and licensing our technology to third parties for integration with products in the recreational, baby wellness and sports monitoring fields.

**REVENUES.** Revenues for the 2011 Period were \$20,000 as compared to \$192,000 in the 2010 Period, all of which derived from the provision of research and development services. The decrease in revenues during the 2011 Period as compared to the 2010 Period is primarily attributable to the cessation by us in February 2011 of all internal research and development activities for third parties.

**COSTS OF REVENUES.** Costs of revenues include all costs related to services provided. Costs of revenues for the 2011 Period were \$10,000 compared to \$151,000 for the 2010 Period. The decrease in cost of revenues is primarily attributable to the cessation by us in February 2011 of all internal research and development activities for third parties, which was the source of our revenues.

**RESEARCH AND DEVELOPMENT EXPENSES, NET.** Research and development expenses, net consist primarily of expenses incurred in the design, development and testing of our products net of government grants and participation by others. These expenses consist primarily of salaries and related expenses for personnel, contract design and testing services, supplies used and consulting and license fees paid to third parties. Research and development expenses, net, for the 2011 Period were \$57,000 compared to \$302,000, for the 2010 Period. The decrease in research and development expenses, net in the 2011 Period as compared to the 2010 Period was primarily attributable to the decrease in the number of employees and other personnel resulting from the cessation by us in 2011 of all internal research and development activities. Research and development expenses, net, in the 2010 Period are net of grant awards received from the Office of the Chief Scientist of the Government of Israel ("OCS") in the amount of \$69,000, which amounts we recognized and offset against expenses in the 2010 Period.

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**SELLING AND MARKETING EXPENSES.** Selling and marketing expenses consist primarily of costs relating to compensation attributable to consultants for the provision of public relations, promotion and marketing services geared to the recreational sports and wellness markets. Selling and marketing expenses for 2011 Period were \$1,142,000, of which \$1,055,000 are stock based non cash expenses, as compared to \$975,000 for the 2010 Period, of which \$721,000 are stock based non cash expenses, which were generated during the 2010 period. The increase in selling and marketing expenses in the 2011 Period as compared to the 2010 Period was primarily attributable to increased business development activities relating to the preparation to enter into the sports and wellness markets.

**GENERAL AND ADMINISTRATIVE EXPENSES.** General and administrative expenses primarily consist of salaries and other related costs for personnel in executive and other administrative functions. Other significant costs include professional fees for legal and accounting services. General and administrative expenses for the 2011 Period were \$606,000 as compared to \$703,000 for the 2010 Period. Administrative expenses decreased due to reduction of professional fees and other general expenses.

**IMPAIRMENT OF PROPERTY AND EQUIPMENT, NET.** In February 2011, we transferred research and development activity to subcontractors and therefore ceased all internal research and development activities which resulted in a impairment to property and equipment in the amount of \$96,000.

**RESTRUCTURING EXPENSES AND RESTRUCTURING OF DEBT (INCOME).** In January 2010, we agreed with our corporate counsel to restructure the monthly retainer amounts paid to them as remuneration for legal services. We recorded other income in the amount of \$64,000 regarding these understandings.

In January 2010, we completed a restructuring plan in an attempt to focus primarily on licensing our core technology for non-medical market applications. The restructuring plan included a reduction of our corporate and manufacturing workforce and entering into an alliance and license agreement as discussed; starting that date, we started operating primarily as a development and licensing entity. In February 2011 we further reduced our research and development capabilities and since that date we operating primarily as and licensing entity with subcontracted research and development services.

**FINANCIAL INCOME (EXPENSE), NET.** Financial income net for the 2011 period was \$188,000. Financial expense net, for the 2010 Period was \$(299,000). The principal expenses comprising the financial expenses, net, were: (i) non cash amortization of warrants granted to lenders in consideration of the extension of the maturity date of loans and the issuance of shares and warrants to financial service providers \$(12,000) and \$(172,000) respectively, (ii) Non-cash financial income (expenses) related to evaluation of warrants to issue shares in the amount of \$200,000 and \$(16,000) respectively (iii) interest in respect of debt instruments and amortization of deferred interest - \$(123,000) and \$(19,000) respectively and (vi) exchange rate differences caused by fluctuations in the exchange rate with the New Israeli Shekel ("NIS") on liabilities denominated in NIS held by the subsidiary- \$126,000 and \$(92,000) respectively. (v) other financial expenses of \$(3,000) in 2011.

**NET INCOME FROM DISCONTINUED OPERATIONS.** Following the entry into the License, we ceased all previous operations associated with the distribution of the PulseOx line in the medical field. During the 2011 period we did not record any net income from discontinued operations.

**NET LOSS.** For the 2011 Period and 2010 Period, we had a net loss of \$1,607,000 and \$2,174,000, respectively. The decrease in net loss for the 2011 Period compared to the 2010 Period is primarily attributable to (i) reduced research and development expenses in the approximate amount of \$248,000 and (ii) income recorded during the 2011 Period in the amount of \$200,000 which is primarily attributable to non-cash financial income related to evaluation of warrants to issue shares.

## LIQUIDITY AND CAPITAL RESOURCES

We need to raise additional funds in order to meet our on-going operating requirements, pay outstanding loans in the aggregate approximate amount of \$1,246,000 and to realize our restructured business plan. In response to the deteriorating global economic conditions that began in 2008, we have taken certain measures in an effort to reduce operating expenses and conserve our cash resources. Beginning in July 2008 we significantly curtailed our non-essential product design and development, marketing activities and reorganized our product manufacturing and delivery system to "just-in-time" arrangements. We have terminated certain product development plans. During 2008 until the end of 2010, we deferred part of management and employee salaries and benefits. As of April 5, 2012, we had two employees working on a full-time basis. As noted above, in our restructured operations, we are pursuing joint ventures, OEM type arrangement, research and or sub contractor agreements relating to our oximetry technology with respect to the recreational, baby wellness and sports monitoring fields. If we are unable to raise capital through a financial raise or joint-venture type of agreement on an immediate basis, it may be necessary for us to take further measures to reduce our cash burn including laying-off additional personnel, or ceasing operations entirely. No assurance can be given that we will be able to raise the needed capital. These conditions raise substantial doubt about our ability to continue as a going concern. Any additional equity financings is likely to be dilutive to holders of our Common Stock and debt financing, if available, may require us to be bound by significant repayment obligations and covenants that restrict our operations.

As at December 31, 2011, we had approximately \$37,000 cash and cash equivalents available to us, compared to no cash and cash equivalents as at December 31, 2010.

We generated negative cash flow from operating activities of approximately \$362,000 during the 2011 Period compared to negative cash flow of \$993,000 for the 2010 Period. The decrease in negative cash flows is primarily attributable to our restructuring process which we initiated in January 2010 to focus primarily on licensing our core technology for non-medical market applications.

In December 2005 we completed the private placement to certain accredited investors that commenced in April 2005 for the issuance of up to \$150,000 of units of its securities, with each unit comprised of (i) the Company's 18 month 6% promissory note (collectively, the "April 2005 Notes") and (ii) three year warrants to purchase up to such number of shares of the Company's Common Stock as are determined by the principal amount of the Note purchased by such investor divided by \$ 0.85 (collectively the "April 2005 Warrants"). The Company and the holders of \$150,000 in principal amount of the April 2005 Notes subsequently agreed to (a) extend the maturity term of the April 2005 Notes through March 26, 2008, (b) extend the exercise period of the April 2005 Warrants from three to five years with an expiration date of September 26, 2010 and adjust the per share exercise price thereof to \$0.60 and (c) increase the interest rate on the amounts outstanding under the April 2005 Notes to 8% per annum, effective July 12, 2006.. All of the extended notes matured on March 26, 2008 and all warrants granted have since expired. On December 31, 2009, we and a holder of \$30,000 agreed to extend the note's maturity date (originally matured March 2007) to December 31, 2011 in consideration of the issuance of warrants to purchase up to 50,000 shares of our common stock, exercisable through the third anniversary of issuance, at a per share exercise price of \$0.01. These warrants were exercised during

2011.

In March 2008, we offered to the holders of the April 2005 Notes to apply the amounts payable to them on the April 2005 Notes, to the exercise price of the April 2005 Warrants, thereby exercising these warrants, and to convert into Common Stock the accrued interest on the 2005 Notes at a per share conversion price of \$0.60. Note holders who accepted this offer were issued new warrants for such number of shares of Common Stock equal to 25% of the number shares issued to them upon exercise of their existing warrants and conversion of the interest accrued on the note. The new warrants were exercisable over three years from the date of issuance at an exercise price of \$0.60 and have since expired. As of December 31, 2009, the holders of approximately \$439,000 in principal amount have agreed to apply the principal amount owed to them to the exercise price of the April 2005 Warrants. Accordingly, approximately \$520,000 in amounts owed under the 2005 Notes have been converted into equity and, accordingly, an aggregate of 866,528 shares of our Common Stock have been issued upon exercise of the April 2005 Warrants and conversion of the interest owing on the April 2005 Notes. Under the terms of the offer, new warrants for 216,636 share of our Common stock have been issued to these April 2005 Note holders, exercisable over three years from the date of issuance. We have been informed by the holders of \$300,000 in principal amount of their election to not accept our offer, of which \$250,000 of principal and the accrued interest thereon has been repaid as of December 31, 2009. On March 15, 2010, we agreed with the holder of an April 2005 Note in the principal amount of \$50,000 to extend the Note's maturity date to September 15, 2010 and, in consideration thereof, we agreed to pay the holder total amount of \$45,000, which was paid in full. On March 15, 2010, we agreed with a holder of an April 2005 Note in the principal amount of \$50 to extend the note's maturity date to September 15, 2010 and, in consideration thereof, we agreed to pay the holder total amount of \$45,000, which was paid in full. On May 31, 2010, we issued to two note holders of the April 2005 Note in principal amount of \$239,000 warrants to purchase up to 600,000 shares of our Common Stock in consideration of such investors' extension from originally March 2008 to December 31, 2011 of the maturity date of April 2005 Notes.. The warrants are exercisable through December 31, 2013 at a per share exercise price of \$0.15. On July 27, 2010, we issued to two holders of the April 2005 Notes a total of 1,370,000 restricted shares of our Common Stock in satisfaction of a note held by one of the accredited investors in the approximate amount of \$202,000 and warrants, exercisable through November 15, 2010 to purchase up to 700,000 shares of tour Common Stock, at a per share exercise price of \$0.15; on November 15, 2010, warrants for 666,667 shares were exercised for cash proceeds to us of \$100,000 As of December 31, 2011, the outstanding April 2005 Notes principal and accrued interest in the aggregate amount of \$624,000.

In July 2006, the Company commenced a private placement of units of its securities the "Loan Notes", with each unit comprised of (i) the Company's 8% month promissory note due 12 months from the date of issuance and (ii) warrants as described below, pursuant to which the Company raised \$550,000. Under the terms of the offering, the principal and accrued interest was due in one balloon payment at the end of the twelve month period. Each purchaser of the notes received warrants, exercisable over a period of two years from the date of issuance, to purchase 16,250 shares of Common Stock for each \$25,000 of principal loaned, at a per share exercise price equal to the lower of \$1.50 or 35% less than any offering price at an initial public offering of the Company's Common Stock during the warrant exercise period. On December 31, 2009 the Company and a holder of a Loan Notes in the principal amount of \$150,000 agreed to extend the note's maturity date to December 31, 2011 in consideration of the issuance of warrants to purchase up to 50,000 shares of the of the Company's Common Stock, at a per share exercise price of \$0.01 exercisable for a period of three years. On June 30, 2010, the company issued 105,074 restricted shares of our Common Stock to a note holder in satisfaction of \$16,000 owed to such holder and the cancellation of previously issued warrants to purchase up to 7,800 shares of the Company's Common Stock. As of December 31, 2011, approximately \$166,000 in respect of the principal and accrued interest on these notes remains outstanding.

In July and September 2010, we raised net proceeds of approximately \$529,000 from the private placement to accredited investors of units of our securities. Each unit offered in the private placement consisted of (i) 200,000 shares of the Company's common stock and (ii) a three-year warrant to purchase 100,000 shares of the Company's Common Stock at a per share exercise price of \$0.25 per share. A total of 4,125,667 shares of Common Stock were issued in this private placement. In addition, Investor Warrants to purchase a total of 2,062,833 shares of Common Stock at the exercise price of \$0.25 per share were issued. The private placement terminated on October 13, 2010.

On December 29, 2010, we and our Chief Executive Officer entered into a loan agreement pursuant to which the Chief Executive Officer loaned to the Company \$30,000 for working capital purposes. The original maturity date of the loan was January 29, 2011. The loan bears interest at a per annum rate of 8%. In January 2011, the maturity date of the loan was extended to April 30, 2011 and in August and November 2011 the \$30,000 loan was repaid.

On March 25, 2011, we and one of our stockholders entered into a loan agreement pursuant to which the stockholder loaned to the Company \$50,000 for working capital purposes. The original maturity date of the loan is March 25, 2012. The loan bears interest at a per annum rate of 8%.

In May 2011, we entered into a Securities Purchase Agreement with an investor pursuant to which we issued an 8% convertible promissory note in the principal amount of \$50,000 that is convertible into shares of our Common Stock. The loan, together with accrued interest, is scheduled to mature in May 2012. Commencing November 4, 2011, the Investor is entitled to convert all or any part of the outstanding and unpaid principal amount on the note, as well as the interest accrued, into shares of the Company's Common Stock at a conversion rate equal to 55% of the average of the five lowest closing sale prices during the ten days preceding the conversion date. For financial reporting purposes, the conversion feature was recorded in short term liabilities at its fair value of \$40,909. Accordingly, the company recorded a discount of \$40,909 on the convertible promissory note to be amortized through November 4 2011.



On May 18, 2011 the Company and an investor signed a Term Sheet regarding an Equity line of credit which was consummated via an Investment Agreement signed on July 7, 2011. According to the Investment Agreement the investor committed to purchase, subject to certain restrictions and conditions, up to \$5,000,000 of the Company's common stock, par value \$0.01 per share over a period of 36 months from the first trading day following the effectiveness of the registration statement registering the resale of shares purchased by the investor pursuant to the Investment Agreement. Pursuant to the terms of a Registration Rights Agreement dated as of July 5, 2011 between the Company and the investor, the Company is obligated to file, by September 5, 2011, a registration statement with the Securities and Exchange Commission to register the resale by the investor of the shares of common stock issued or issuable under the Investment Agreement. The Company is required to initially register 10,000,000 shares of common stock. The Company is obligated to use all commercially reasonable efforts to have the registration statement declared effective within 90 days after the filing. In connection with the Investment Agreement, the Company issued 166,666 shares of its Common Stock as a document preparation fee. As of April 5, 2012 we have not filed this registration statement.

In June 2011, we received from investor net proceeds of \$25,000 in consideration for the purchase of shares of our Common Stock. In connection therewith, in June 2011, the Company issued to the investor 166,667 shares of the Company's Common Stock.

In August and November, 2011, we received \$75,000 and \$200,000 from existing investors on account for loans. The loans are scheduled to mature in August and November 2013 and bear interest at the rate of 10% per annum. Principal and accrued interest is convertible into shares of our common stock at the option of the holder at the conversion price of \$0.15 per share. In January 2012 the Company issued to the investor warrants, exercisable through August and November, 2015, to purchase, in the aggregate, up to 916,668 shares of our common stock at a per share exercise price of \$0.15.

### **Recently Issued Accounting Pronouncements**

In May 2011, the FASB issued ASU 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards ("IFRSs")." Under ASU 2011-04, the guidance amends certain accounting and disclosure requirements related to fair value measurements to ensure that fair value has the same meaning in U.S. GAAP and in IFRS and that their respective fair value measurement and disclosure requirements are the same. ASU 2011-04 is effective for public entities during interim and annual periods beginning after December 15, 2011. Early adoption is not permitted. The Company does not believe that the adoption of ASU 2011-04 will have a material impact on the Company's results of operation and financial condition.

In June 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income (ASC Topic 220): Presentation of Comprehensive Income," ("ASU 2011-05") which amends current comprehensive income guidance. This accounting

update eliminates the option to present the components of other comprehensive income as part of the statement of shareholders' equity. Instead, comprehensive income must be reported in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. ASU 2011-05 will be effective for public companies during the interim and annual periods beginning after Dec. 15, 2011 with early adoption permitted. The Company does not believe that the adoption of ASU 2011-05 will have a material impact on the Company's results of operation and financial condition.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not Applicable.

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The information called for by this Item 8 is included following the "Index to Consolidated Financial Statements" contained in this Annual Report on Form 10-K.

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

## **ITEM 9A(T). CONTROLS AND PROCEDURES**

### **EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES.**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer, as appropriate, to allow timely decisions regarding required disclosure based closely on the definition of "disclosure controls and procedures" in Rule 13a-14(c).

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with participation of management, including our Chief Executive Officer, who serves as our principal executive officer and principal financial and accounting officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report to provide reasonable assurance that material information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

Management is aware that there is a lack of segregation of duties due to the small number of employees dealing with general administrative and financial matters. However, at this time, management has decided that considering the employees involved, the control procedures in place, and the outsourcing of certain financial functions, the risks associated with such lack of segregation are low and the potential benefits of adding additional employees to clearly

segregate duties do not justify the expenses associated with such increases. Management will periodically reevaluate this situation. If the volume of the business increases and sufficient capital is secured, it is our intention to increase staffing to mitigate the current lack of segregation of duties within the general administrative and financial functions.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected. Such limitations include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures, such as simple errors or mistakes or intentional circumvention of the established process.

#### MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING; CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING.

During the course of 2011 we affected a series of reductions in workforce that caused the number of our employees to drop from six as of December 31, 2010, to two as of December, 2011. As a result of this decline, we were unable to ensure a proper segregation of duties amongst different employees. This had an effect on our internal controls over financial reporting, primarily in the authorization, monitoring and segregation of duties.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our management, has, with the assistance of external financial advisor and our audit committee, conducted an evaluation of the effectiveness of our internal control over financial reporting. Our management assessed the effectiveness of its internal control over financial reporting as of December 31, 2011. In making this assessment, management employed the framework incorporated under the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control - Integrated Framework. Based on use of this framework, management believes that, as of December 31, 2011, the Company's internal control over financing reporting is effective based on those criteria.

During the quarter ended December 31, 2011, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### **ITEM 9B. OTHER INFORMATION**

None.

### **PART III**

#### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

##### **Management**

The individuals who serve as our executive officers and directors are:

| NAME             | AGE | POSITION                                        |
|------------------|-----|-------------------------------------------------|
| Michael Braunold | 52  | President, Chief Executive Officer and Director |
| Sidney Braun     | 52  | Director (1)                                    |

(1) Audit Committee and Compensation Committee Member.

The business experience, principal occupations and employment, as well as the periods of service, of each of our directors and executive officers during at least the last five years are set forth below.

MICHAEL BRAUNOLD has been Chief Executive Officer of SPO Ltd. since March 1998 and the President and Chief Executive Officer of the Company since May 18, 2005. Prior to March 1998, Mr. Braunold was Senior Director of Business Development at Scitex Corporation Ltd., a multinational corporation specializing in visual information communication. In such capacity, Mr. Braunold played a strategic role in managing a team of professionals assigned to M&A activities. During his 12-year tenure at Scitex, he held various positions within the worldwide organization, including a period in the United States as Vice President of an American subsidiary of Scitex specializing in medical imaging. From March 2000 through September 2000, Mr. Braunold was also the Chief Executive Officer and Chairman of Ambient Corporation, a Delaware company, that specializes in the implementation of a proposed comprehensive high-speed communication infrastructure that is designed to utilize existing electrical power distribution lines as a high-speed communication medium. Mr. Braunold served as a director of Amedia Networks, Inc. (formerly TTR Technologies, Inc.) from February 2000 through August 2002. Mr. Braunold obtained a Bachelor of Science degree with honors in Engineering and Management Sciences from Imperial College Business School, London. Mr. Braunold as Chief Executive Officer of the company along with his seasoned corporate experience makes him well suited to confront the challenges our company faces.

SIDNEY BRAUN has served as a director since April 21, 2005. From June 2004 to September 2006, Mr. Braun has served as the President and Chief Operating Officer for Med-Emerg International Inc. (MEII), a company incorporated in the Province of Ontario. Since September 2006, Mr. Braun is also a director of Romlight International (USA) Inc., a developer and manufacturer of electronic ballasts and Romlight International (Canada) Inc. Since June 2009, Mr. Braun has served on the board of directors of AIM Health Group, a publically listed company on TSVX and as a member of their Audit Committee. Mr. Braun has extensive experience in commerce both in North America and Europe, including manufacturing, distribution and trading. Prior to his position at MEII and Romlight, Mr. Braun worked for 7 years as an independent consultant to several large state-owned corporations from the former Eastern European block on developing business strategies and adapting to new working conditions in western markets. In addition, Mr. Braun developed expertise in emerging financial markets in Europe and introduced several companies to the UK and German capital markets. Mr. Braun's wide experience both as an entrepreneur and in the finance markets affords the company access to wide array of prospective financing parties.

## Resignations

On May 15, 2011, Ms. Pauline Dorfman resigned from our board of directors in order to pursue other interest.

## Committees of the Board of Directors

Our Board of Directors operates with the assistance of the Audit Committee and the Compensation Committee. Due to the small size of our Board, we do not presently maintain a formal nominating committee. The entire Board participates in the process of nominating candidates for the Board of Directors.

The function of the Audit Committee is to (i) make recommendations to the full Board of Directors with respect to appointment of our independent public accountants, and (ii) meet periodically with our independent public accountants to review the general scope of audit coverage, including consideration of internal accounting controls and financial reporting.

The Board of Directors has determined that at present we have no audit committee financial expert serving on the Audit Committee. Between April 2005 and May 15, 2011, Ms. Pauline Dorfman served as our "Audit Committee Financial Expert" for purposes of the SEC's rules. Ms. Dorfman resigned as of May 15, 2011.

The Compensation Committee sets compensation policy and administers our cash and equity incentive programs for the purpose of attracting and retaining skilled executives who will promote the Company's business goals and build

shareholder value. The committee is also responsible for reviewing and making recommendations to the Board regarding all forms of compensation to be provided to the Company's named executive officers, including stock compensation and bonuses.

### **Board of Directors; Appointment of Officers**

All directors are elected by a plurality vote at the annual meeting of the shareholders, and hold office until a successor is duly elected and qualified. Any vacancy occurring in the Board of Directors may be filled by the stockholders, the Board of Directors, or if the Directors remaining in office constitute less than a quorum of the Board of Directors, they may fill the vacancy by the affirmative vote of a majority of the Directors remaining in office. A director elected to fill a vacancy is elected for the unexpired term of his predecessor in office. Any directorship filled by reason of an increase in the number of directors shall expire at the next shareholders' meeting in which directors are elected, unless the vacancy is filled by the shareholders, in which case the term shall expire on the later of (i) the next meeting of the shareholders or (ii) the term designated for the director at the time of creation of the position being filled.

Our executive officers are appointed by our board of directors. Each officer shall hold office until the earlier of: his death; resignation or removal from office; or the appointment and qualification of his successor.

**CODE OF ETHICS**

We have adopted a code of ethics that applies to our chief executive officer, president, chief financial officer, controller and others performing similar executive and financial functions at the Company. A copy of our policy was attached as an exhibit to our annual report on Form 10-KSB for the year ended December 31, 2005. We intend to satisfy the disclosure requirement under Item 10 of Form 8-K regarding an amendment to, or waiver from, a provision of this code of ethics by posting such information on our Website, at the address and location specified above.

**SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires each of our officers and directors and each person who owns more than 10% of a registered class of our equity securities to file with the SEC an initial report of ownership and subsequent reports of changes in such ownership. Such persons are further required by SEC regulation to furnish us with copies of all Section 16(a) forms (including Forms 3, 4 and 5) that they file. Based solely on our review of the copies of such forms received by us with respect to fiscal year 2011, or written representations from certain reporting persons, we believe all of our directors and executive officers met all applicable filing requirements.

**ITEM 11. EXECUTIVE COMPENSATION**

The following table sets forth all compensation for the last fiscal year awarded to, earned by, or paid to our Chief Executive Officer, our sole executive officer (the "Named Executive Officer").

**SUMMARY COMPENSATION TABLE**

| Name & Principal Position             | Year | Salary (\$)    | Bonus (\$) | Option Awards (\$) | All Other Compensation (\$) | Total (\$)    |
|---------------------------------------|------|----------------|------------|--------------------|-----------------------------|---------------|
| MICHAEL BRAUNOLD                      | 2010 | \$ 189,743 (1) | —          | —                  | \$ 57,241                   | (2) \$246,984 |
| President and Chief Executive Officer | 2011 | \$ 159,000 (3) | —          | —                  | \$ 43,991                   | (4) \$202,991 |

(1) Of this amount, \$109,210 was paid in 2010 and \$80,533 is being deferred.

Reflects payments made by us in connection with a leased automobile and related benefits (\$15,581) and (2) contributions to insurance premiums paid under Israeli law for pension, severance and further education funds (\$41,660 of which \$19,736 is being deferred).

(3) Of this amount, \$28,297 was paid in 2011 and \$130,703 is being deferred.

Reflects payments made by us in connection with a leased automobile and related benefits (\$3,303) and (4) contributions to insurance premiums paid under Israeli law for pension, severance and further education funds (\$40,688 of which \$35,592 is being deferred).

#### **Outstanding Equity Awards at Fiscal Year End**

The following table sets forth information concerning unexercised options and stock that has not vested for each of our executive officers named in the Summary Compensation Table that are outstanding as of December 31, 2011.

**OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END DECEMBER 31, 2011**

| Name             | Number of Securities<br>Underlying<br>Unexercised Options<br>(#)(1)<br>Exercisable | Number of Securities<br>Underlying<br>Unexercised Options<br>(#)<br>Unexercisable | Equity Incentive Plan<br>Awards: Number of<br>Securities Underlying<br>Unexercised Unearned<br>Options (#) | Option Exercise<br>Price<br>(\$) | Option Expiration<br>Date |
|------------------|------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|----------------------------------|---------------------------|
| Michael Braunold | 250,000                                                                            | —                                                                                 | —                                                                                                          | \$ 0.60                          | 12/22/2015                |
|                  | 200,000                                                                            | —                                                                                 | —                                                                                                          | \$ 0.13                          | 12/05/2018                |

(1) Options were issued under our 2005 Equity Incentive Plan and are fully vested.

**EMPLOYMENT AGREEMENTS WITH EXECUTIVE OFFICERS**

**MICHAEL BRAUNOLD.** On May 18, 2005, we entered into an employment agreement with Michael Braunold, pursuant to which he serves as our Chief Executive Officer and President. On such date, Mr. Braunold and SPO Ltd., entered into an employment agreement pursuant to which Mr. Braunold serves as SPO Ltd.'s Chief Executive Officer. Each of the agreements with us and SPO Ltd. continues in effect through May 18, 2010; thereafter, the agreement and is automatically renewable for successive two year terms unless we or Mr. Braunold indicate in writing, upon 90 days prior to the scheduled termination of the term that such party does not intend to renew the agreement. Mr. Braunold is currently entitled to a monthly salary of \$13,250 under the agreement with SPO Ltd. However, in order to reduce operating expenses and conserve cash, since July 2008 Mr. Braunold has been deferring a part of his salary and social benefits due thereon until such time as our cash position permits payment of salary in full without interfering with our ability to pursue our plan of operations, and, as of December 31, 2011, such deferred amount totaled an aggregate of \$417,891. The agreements may be terminated by Mr. Braunold for any reason on 60 days written notice or for Good Reason (as defined in the employment agreement) or by us for Just Cause (as defined in the employment agreement) or for any other reason. In the event of a termination by Mr. Braunold for Good Reason or by us for any reason other than Just Cause, we are to pay Mr. Braunold an amount equal to (i) if such termination occurs during the initial term of the agreement, the base salary then payable, if any, for the longer of (a) the period from the date of such termination to the end of the initial term as if the agreement had not been so terminated and (b) twelve months and (ii) if such termination occurs after the initial term, the base salary then payable, if any, for a period of twelve months as if the agreement had not been so terminated. Mr. Braunold is not entitled to a salary under the agreement with us was granted options in December 2005 under our 2005 Equity Incentive Plan (the "2005 Plan") to purchase up to 250,000 shares of our Common Stock at a per share exercise price of \$0.60, all of which options are currently exercisable. In December 2008, Mr. Braunold was awarded options to purchase up to 200,000 additional shares of Common Stock under the 2005 Plan, at a per share exercise price of \$0.13, all of which options were exercisable upon grant.

The agreement includes certain customary intellectual property development rights, confidentiality and non-compete provisions that prohibit the executive from competing with us for one year, or soliciting our employees for one year, following the termination of his employment.

## COMPENSATION OF DIRECTORS

The following table summarizes data concerning the compensation of our non-employee directors for the fiscal year ended December 31, 2011.

|                     | Fees Earned<br>or paid | Option<br>Awards(\$) | Total    |
|---------------------|------------------------|----------------------|----------|
| Sidney Braun        | \$ 10,000              | (1)                  | \$10,000 |
| Pauline Dorfman (2) | \$ 5,000               | (3)                  | \$5,000  |

(1) Of this amount, \$10,000 is being deferred.

(2) Ms. Dorfman resigned on May 15, 2011.

(3) Of this amount, \$5,000 is being deferred.

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth information as of the close of business on April 5, 2011, concerning shares of our common stock beneficially owned by each director and named executive officer, each other person beneficially owning more than 5% of our Common Stock and by all directors and executive officers as a group.

In accordance with the rules of the SEC, the table gives effect to the shares of common stock that could be issued upon the exercise of outstanding options and warrants within 60 days of April 15, 2012. Unless otherwise noted in the footnotes to the table and subject to community property laws where applicable, the following individuals have sole voting and investment control with respect to the shares beneficially owned by them. We have calculated the percentages of shares beneficially owned based on 41,779,650 shares of Common Stock outstanding at April 5, 2012.

| Name of Beneficial Owner (1)                      | Common Stock<br>Percentage of<br>Beneficially Owned<br>(2) | Common Stock |       |
|---------------------------------------------------|------------------------------------------------------------|--------------|-------|
| Michael Braunold                                  | 1,193,922                                                  | (3)          | 2.9 % |
| Pauline Dorfman                                   | 175,000                                                    | (4)          | *     |
| Sidney Braun                                      | 175,000                                                    | (4)          | *     |
| All officers and directors as a group (3 persons) | 1,543,922                                                  |              | 3.7 % |

\*Less than 1%

(1) Except as otherwise indicated, the address of each beneficial owner is c/o SPO Medical, 3 Gavish Street, POB 2454, Kfar Saba, Israel 44425.

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Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to the shares shown. Except where indicated by (2) footnote and subject to community property laws where applicable, the persons named in the table have sole voting and investment power with respect to all shares of voting securities shown as beneficially owned by them.

(3) Includes 450,000 shares of our Common Stock that are issuable upon exercise of vested options issued under our 2005 Equity Incentive Plan (the "2005 Plan").

Represents (i) shares issuable upon exercise of currently exercisable options under the Company's 2005 (4) Non-Employee Directors Stock Option Plan and (ii) warrants to purchase 100,000 shares of our Common Stock issued in December 2009.

## EQUITY COMPENSATION PLAN INFORMATION

We have two compensation plans (excluding individual stock option grants outside of such plans) under which our equity securities are authorized for issuance to employees, directors and consultants in exchange for services - the 2005 Equity Incentive Plan (the "2005 Plan") and the 2005 Non-Employee Directors Stock Option Plan (the "2005 Directors Plan"; together with the 2005 Plan, the "Plans"). Our shareholders have approved these plans.

The following table presents information as of December 31, 2011 with respect to compensation plans under which equity securities were authorized for issuance, including the 2005 Plan and the Non-Employee Directors Plan and agreements granting options or warrants outside of these plans.

|                                                            | NUMBER OF<br>SECURITIES<br>TO BE ISSUED<br>UPON<br>EXERCISE<br>OF<br>OUTSTANDING<br>OPTIONS,<br>WARRANTS<br>OR RIGHTS | WEIGHTED-<br>AVERAGE<br>EXERCISE PRICE<br>OF<br>OUTSTANDING<br>OPTIONS,<br>WARRANTS<br>OR RIGHTS | NUMBER OF<br>SECURITIES<br>REMAINING<br>AVAILABLE FOR<br>FUTURE ISSUANCE<br>UNDER<br>EQUITY COMPENSATION<br>PLANS |
|------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------|
| Equity compensation plans approved by security holders     | 1, 900,000                                                                                                            | \$ 0.39                                                                                          | 50,000                                                                                                            |
| Equity compensation plans not approved by security holders | 14,265,312                                                                                                            | \$ 0.08                                                                                          |                                                                                                                   |
| Total                                                      | 16,165,312                                                                                                            | \$ 0.11                                                                                          | 50,000                                                                                                            |

## NON-SHAREHOLDER APPROVED PLANS

The following is a description of options and warrants granted to employees, directors, advisory directors and consultants that were outstanding as of December 31, 2011.

As of December 31, 2011, we had outstanding options and warrants to purchase an aggregate of 14,265,312 shares of our Common Stock which were granted outside of the Plans. These are comprised of the following: (i) Penny warrants issued to a former executive officer (446,383), to service providers (9,431,000), to employees (345,000) and to a former CFO (200,000), (ii) 3,742,929 warrants issued to service providers (iii) 100,000 warrants issued to Directors in

lieu of fees owed to them.

### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

#### **Certain Relationships and Related Transactions**

Since the beginning of its last fiscal year, the Company has not engaged in any transaction, or any proposed transaction, to which the Company or any of its subsidiaries was or is to be a party and (1) in which the amount involved exceeds the lesser of \$120,000 or one percent of the average of the Company's assets at year end for the last three completed fiscal years and (2) in which any of the Company's directors, nominees for director, executive officers or beneficial owners of more than 5% of its Common Stock, or members of the immediate families of those individuals, had or will have, a direct or indirect material interest.

**Director Independence**

The Board believes that each of Sidney Braun and Pauline Dorfman meets the independence criteria set out in Rule 4200(a)(14) of the Marketplace Rules of the National Association of Securities Dealers and the rules and other requirements of the SEC. Mr. Braun and Ms. Dorfman were appointed to the Audit Committee in 2005, and are presently the sole members of the committee.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES****Audit and Non-Audit Fees**

The following table presents fees for professional audit services rendered by Brightman Almagor Zohar & Co., Certified Public Accountants, a member firm of Deloitte Touche Tohmatsu Limited, for the audit of our annual financial statements for the year ended December 31, 2010 and 2011.

|                    | Fiscal Year<br>Ended<br>December 31,<br>2011 | Fiscal Year<br>Ended<br>December 31,<br>2010 |
|--------------------|----------------------------------------------|----------------------------------------------|
| Audit Fees         | \$ 26,500                                    | \$ 26,500                                    |
| Audit Related Fees | \$ —                                         | —                                            |
| Tax Fees           | \$ 3,500                                     | \$ 3,500                                     |
| All Other Fees     | \$ —                                         | —                                            |
| Total              | \$ 30,000                                    | \$ 30,000                                    |

AUDIT FEES were for professional services rendered for the audits of our consolidated financial statements, quarterly review of the financial statements included in our Quarterly Reports on Form 10-QSB, consents, and other assistance required to complete the year-end audit of the consolidated financial statements.

AUDIT-RELATED FEES were for assurance and related services reasonably related to the performance of the audit or review of financial statements and not reported under the caption Audit Fees.

TAX FEES were for professional services related to tax compliance, tax authority audit support and tax planning.

All OTHER FEES include professional advisory fees relating to Company's efforts to raise additional funds through a public offering of our securities outside the United States.

Our audit committee (the "Audit Committee") reviews non-audit services rendered for each year and determines whether such services are compatible with maintaining the accountants' independence. The Audit Committee's policy is to pre-approve all audit services and all non-audit services that our independent public accountants are permitted to perform for us under applicable federal securities regulations. As permitted by the applicable regulations, the Audit Committee's policy utilizes a combination of specific pre-approval on a case-by-case basis of individual engagements of the independent public accountants and general pre-approval of certain categories of engagements up to predetermined dollar thresholds that are reviewed annually by the Audit Committee. Specific pre-approval is mandatory for, among other things, the annual financial statement audit engagement.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

The following exhibits are incorporated herein by reference or are filed with this report as indicated below.

#### EXHIBIT NO. EXHIBIT

|       |                                                                                                                                                       |
|-------|-------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1   | Restated Capital Stock Exchange Agreement dated as of April 21, 2005 among the Company, SPO Ltd. and the SPO Ltd. shareholders specified therein. (1) |
| 3.1*  | Amended and Restated Certificate of Incorporation of the Company.                                                                                     |
| 3.2   | Bylaws of the Company (1)                                                                                                                             |
| 3.3   | Articles of Association of SPO Medical Equipment Ltd.                                                                                                 |
| 4.1   | Form of Promissory Note issued to certain investors. (1)                                                                                              |
| 4.2   | Form of Warrant Instrument issued to certain investors.(1)                                                                                            |
| 4.3   | Form of Promissory Note issued in connection with the Subscription Agreement referred to in Item 10.1. (5)                                            |
| 4.4   | Form of Warrant issued in connection with the Agreement referred to in Item 10.1 (5)                                                                  |
| 4.5   | Form of Warrant (8)                                                                                                                                   |
| 4.6   | Form of Common Stock Purchase Warrant (8)                                                                                                             |
| 4.7   | Form of Investor Warrant used in the Financing Referred to in Exhibit 10.20. (11)                                                                     |
| 10.1  | Form of subscription Agreement with certain investors.                                                                                                |
| 10.2  | Employment Agreement effective as of May 18, 2005 between the Company and Michael Braunold. (2)+                                                      |
| 10.3  | Employment Agreement effective as of May 18, 2005 between SPO Ltd. and Michael Braunold. (2)+                                                         |
| 10.4  | Employment Agreement effective as of July 14, 2005 between the Company and Jeffrey Feuer. (3)                                                         |
| 10.5  | Employment Agreement effective as of July 14, 2005 between SPO Ltd. and Jeffrey Feuer. (3)                                                            |
| 10.6  | Company's 2005 Equity Incentive plan                                                                                                                  |
| 10.7  | Company's 2005 Non-Employee Directors Stock option Plan                                                                                               |
| 10.8  | Stock Purchase Agreement dated as of January 10, 2006 between SPO Medical Inc. and the investor specified therein. (4)                                |
| 10.9  | Form of Subscription Agreement between SPO Medical Inc. and certain Buyers (5)                                                                        |
| 10.10 | Form of First Amendment to Subscription Agreement between SPO Medical Inc. and parties thereto. (5)                                                   |
| 10.11 | Confidential Private Placement Subscription Agreement dated as of July 7, 2007 by and between SPO Medical Inc. and Rig III                            |
| 10.12 | Form of Agreement Relating to the Conversion of outstanding Debt Instruments                                                                          |
| 10.13 | Form of Warrant Exercise and Note Conversion Agreement dated as of March 26, 2008 (8)                                                                 |
| 10.14 | Form of Second Amendment to an SPO Subscription Agreement (8)                                                                                         |
| 10.15 | Form of Subscription Agreement (8)                                                                                                                    |
| 10.16 | Mutual Release and Waiver dated as of April 16, 2008 between SPO Medical Inc. and Active Health Care Inc.(9)                                          |

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|         |                                                                                                                                                                                     |
|---------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.17   | Settlement Agreement dated as of December 24, 2009 between SPO Medical Equipment Ltd and Jeff Feuer. (10)                                                                           |
| 10.18   | Settlement Agreement dated as of December 24, 2009 between SPO Medical Inc. and Jeff Feuer.<br>(10)                                                                                 |
| 10.19   | Alliance and License Agreement, dated as of December 1, 2009 between SPO Medical Equipment Ltd. and SPO Medical Systems Ltd. (10)                                                   |
| 10.20   | Placement Agency Agreement dated as of July 12, 2010 by and between SPO Medical Inc. and Emerson Equity LLC.                                                                        |
| 10.21   | Form of Subscription Agreement.                                                                                                                                                     |
| 14.1    | Code of Conduct (6)                                                                                                                                                                 |
| 31*     | Certification of the Chief Executive Officer (Principal Executive officer and Principal financial and accounting officer) pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32*     | Certification of the Chief Executive Officer (Principal Executive officer and Principal financial and accounting officer) pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS | XBRL Instance Document                                                                                                                                                              |
| 101.SCH | XBRL Taxonomy Extension Schema                                                                                                                                                      |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase                                                                                                                                        |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase                                                                                                                                         |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase                                                                                                                                              |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase                                                                                                                                       |

+ Management Agreement

\* Attached hereto

- (1) Incorporated by reference to Current Report on Form 8-K filed April 27, 2005.
- (2) Incorporated by reference to the Company's Quarterly Report Form 10-QSB for the quarter ended June 30, 2005
- (3) Incorporated by reference to the Company's Quarterly Report Form 10-QSB for the quarter ended September 30, 2005
- (4) Incorporated by reference to the Company's Quarterly Report Form 10-QSB for the quarter ended March 31, 2006
- (5) Incorporated by reference to the Company's Quarterly Report Form 10-QSB for the quarter ended September 30, 2006
- (6) Incorporated by reference to the Company's Annual Report Form 10-KSB for the fiscal year ended December 31, 2006
- (7) Incorporated by reference to the Company's Quarterly Report Form 10-QSB for the quarter ended September 30, 2007
- (8) Incorporated by reference to the Company's Quarterly Report Form 10-QSB for the quarter ended March 31, 2008
- (9) Incorporated by reference to the Company's Quarterly Report Form 10-QSB for the quarter ended June 30, 2008
- (10) Incorporated by reference to the Company's Annual Report Form 10-K for the year ended December 31, 2010
- (11) Incorporated by reference to the Company's Quarterly Report Form 10-Q for the quarter ended September 30, 2010

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

DATE: April 5, 2012 /s/ Michael Braunold

Michael Braunold

Chief Executive Officer (Principal Executive Officer  
and Principal Financial and Accounting Officer) and  
Director

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the issuer and in the capacities and on the dates indicated.

| SIGNATURE                                | TITLE                                           | DATE          |
|------------------------------------------|-------------------------------------------------|---------------|
| /s/ Sidney Braun<br>Sidney Braun         | Chairman, Director                              | April 5, 2012 |
| /s/ Michael Braunold<br>Michael Braunold | President, Chief Executive Officer and Director | April 5, 2012 |

**SPO MEDICAL INC. AND ITS SUBSIDIARY**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2011**

**U.S. DOLLARS IN THOUSANDS**

**INDEX**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Stockholders of**

**SPO MEDICAL INC.**

We have audited the accompanying consolidated balance sheets of SPO MEDICAL INC. ("the Company") and its subsidiary as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in stockholders' deficiency and cash flows for each of the two years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements, present fairly, in all material respects, the financial position of the Company and its subsidiary as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United states of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company's recurring losses from operations and deficiency in shareholders' equity raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also described in Note 2. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Brightman Almagor Zohar & Co.

Brightman Almagor Zohar & Co.

Certified Public Accountants

A member firm of Deloitte Touche Tohmatsu Limited

Tel-Aviv, Israel

April 5, 2012

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**SPO MEDICAL INC.****CONSOLIDATED BALANCE SHEETS****U.S. dollars in thousands (except share data)**

|                                                 | Note   | December 31,<br>2011 | 2010  |
|-------------------------------------------------|--------|----------------------|-------|
| <b>ASSETS</b>                                   |        |                      |       |
| <b>CURRENT ASSETS</b>                           |        |                      |       |
| Cash and cash equivalents                       |        | \$37                 | \$-   |
| Prepaid expenses and other accounts receivable  |        | 4                    | 34    |
|                                                 |        | 41                   | 34    |
| <b>LONG TERM INVESTMENTS</b>                    |        |                      |       |
| Severance pay fund                              |        | 122                  | 181   |
|                                                 |        | 122                  | 181   |
| <b>PROPERTY AND EQUIPMENT, NET</b>              | 4      | -                    | 111   |
| Total net assets                                |        | \$163                | \$326 |
| <b>LIABILITIES AND STOCKHOLDERS' DEFICIENCY</b> |        |                      |       |
| <b>Current Liabilities</b>                      |        |                      |       |
| Overdraft                                       |        | \$5                  | \$8   |
| Short-term loans, net                           | 5      | 1,170                | 776   |
| Trade payables                                  |        | 6                    | 45    |
| Employees and Payroll accruals                  | 6      | 529                  | 463   |
| Accrued expenses and other liabilities          | 7      | 631                  | 621   |
|                                                 |        | 2,341                | 1,913 |
| <b>Long-Term Liabilities</b>                    |        |                      |       |
| Warrants to issue shares                        | 9 & 10 | 17                   | 218   |
| Long-Term Loans                                 |        | 71                   | -     |
| Accrued severance pay                           | 8      | 213                  | 313   |
|                                                 |        | 301                  | 531   |
| <b>COMMITMENTS AND CONTINGENT LIABILITIES</b>   | 15     |                      |       |
| <b>STOCKHOLDERS' DEFICIENCY</b>                 | 10     |                      |       |
| Stock capital                                   |        |                      |       |
| Preferred stock of \$0.01 par value             |        |                      |       |

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Authorized - 2,000,000 shares, issued and outstanding - none

Common stock \$0.01 par value-

Authorized - 100,000,000 and 50,000,000 shares, issued and outstanding - 36,173,249 and 32,482,340 shares as at December 31, 2011 and 2010, respectively

Additional paid-in capital

Accumulated deficit

|          |          |
|----------|----------|
| 359      | 325      |
| 17,274   | 16,062   |
| (20,112) | (18,505) |
| (2,479 ) | (2,118 ) |

Total liabilities and stockholders' deficiency

|       |       |
|-------|-------|
| \$163 | \$326 |
|-------|-------|

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

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**SPO MEDICAL INC.****CONSOLIDATED STATEMENT OF OPERATIONS****U.S. dollars in thousands (except share data)**

|                                                                                                       |      | Year ended December 31 |             |
|-------------------------------------------------------------------------------------------------------|------|------------------------|-------------|
|                                                                                                       | Note | 2011                   | 2010        |
| Revenues                                                                                              |      | \$20                   | \$192       |
| Cost of revenues                                                                                      |      | 10                     | 151         |
| Gross profit                                                                                          |      | 10                     | 41          |
| Operating expenses                                                                                    |      |                        |             |
| Research and development, net                                                                         | 11   | 57                     | 302         |
| Selling and marketing                                                                                 |      | 1,142                  | 975         |
| General and administrative                                                                            |      | 522                    | 703         |
| Impairment of property and equipment, net                                                             |      | 96                     | -           |
| Restructuring of debt                                                                                 | 12   | -                      | (64 )       |
| Total operating expenses                                                                              |      | 1,817                  | 1,916       |
| Operating loss                                                                                        |      | (1,807 )               | (1,875 )    |
| Financial income (expense), net                                                                       | 13   | 200                    | (299 )      |
| Net Loss for the year                                                                                 |      | \$(1,607 )             | \$(2,174 )  |
| Basic and diluted loss per share                                                                      |      | \$(0.05 )              | \$(0.08 )*  |
| Weighted average number of shares outstanding used in computation of basic and diluted loss per share |      | 33,570,581             | 28,369,367* |

\* Restated to the correct amounts

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

**SPO MEDICAL INC.****STATEMENTS OF CHANGES IN STOCKHOLDERS' DEFICIENCY****U.S. dollars in thousands (except share data)**

|                                                                                                                                                        | Stock capital | <b>Additional<br/>paid-in<br/>capital</b> | Accumulated<br>deficit | Total     |
|--------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|-------------------------------------------|------------------------|-----------|
| Balance as of January 1, 2010                                                                                                                          | \$ 252        | \$ 14,403                                 | \$ (16,331 )           | \$(1,676) |
| Issuance of ordinary stock to service providers                                                                                                        | 6             | 91                                        |                        | 97        |
| Benefit on issued warrants to service providers                                                                                                        |               | 720                                       |                        | 720       |
| Issuance of ordinary stock upon settlement of unpaid principal and accrued interest                                                                    | 22            | 300                                       |                        | 322       |
| Amortization of deferred stock-based compensation related to options granted to employees in restructuring                                             |               | 2                                         |                        | 2         |
| Capital raise, net                                                                                                                                     | 41            | 285                                       |                        | 326       |
| Amortization of deferred stock-based compensation related to warrants granted to employees in consideration of unpaid salaries and employment benefits |               | 89                                        |                        | 89        |
| Exercise of Penny warrants                                                                                                                             | 4             |                                           |                        | 4         |
| Issuance of warrants in connection with extension of loans and accrued interest                                                                        |               | 172                                       |                        | 172       |
| Net Loss                                                                                                                                               |               |                                           | (2,174 )               | (2,174)   |
| Balance as of December 31, 2010                                                                                                                        | 325           | 16,062                                    | (18,505 )              | (2,118)   |
| Issuance of ordinary stock to service providers                                                                                                        | 25            | 118                                       |                        | 143       |
| Issuance of warrants to service providers                                                                                                              |               | 1079                                      |                        | 1,079     |
| Exercise of Penny warrants                                                                                                                             | 1             |                                           |                        | 1         |
| Extension of options to employees                                                                                                                      |               | 13                                        |                        | 13        |
| Conversion of convertible debt to shares                                                                                                               | 8             | 2                                         |                        | 10        |
| Net Loss                                                                                                                                               |               |                                           | (1,607 )               | (1,607)   |
| Balance as of December 31, 2011                                                                                                                        | \$ 359        | \$ 17,274                                 | \$ (20,112 )           | \$(2,479) |

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

**SPO MEDICAL INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****U.S. dollars in thousands (except share data)**

|                                                                           | Year ended December 31,<br>2011 | 2010        |
|---------------------------------------------------------------------------|---------------------------------|-------------|
| Cash Flows from Operating Activities                                      |                                 |             |
| Net Loss for the period                                                   | \$ (1,607 )                     | \$ (2,174 ) |
| Adjustments to reconcile loss to net cash used in operating activities:   |                                 |             |
| Depreciation                                                              | 15                              | 36          |
| Stock-based compensation expenses related to employees, service providers | 1,236                           | 986         |
| Grant of common stock to service providers                                | -                               | 95          |
| Non-cash expenses related to warrants to issue shares                     | -                               | 15          |
| Income from settlements with lenders and employees                        | -                               | (64 )       |
| Warrants liability valuation                                              | (201 )                          | -           |
| Impairment of property and equipment, net                                 | 96                              | -           |
| Changes in assets and liabilities:                                        |                                 |             |
| Increase in accrued interest payable on loans                             | 73                              | 54          |
| Decrease in trade receivables                                             | -                               | 15          |
|                                                                           | 30                              | 17          |

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|                                                        |      |    |      |     |
|--------------------------------------------------------|------|----|------|-----|
| Decrease in prepaid expenses and other receivables     |      |    |      |     |
| Increase (decrease) in accounts payable                | (39  | )  | 13   |     |
| Increase (decrease) in accrued severance pay, net      | (41  | )  | 3    |     |
| Increase in accrued expenses and other liabilities     | 76   |    | 11   |     |
| Net cash used in operating activities                  | (362 | )  | (993 | )   |
| Cash Flows from Investing Activities                   |      |    |      |     |
| Cash from sale of licensee                             | -    |    | 100  |     |
| Purchase of property and equipment                     | -    |    | (6   | )   |
| Net cash provided by investing activities              | -    |    | 94   |     |
| Cash Flows from Financing Activities                   |      |    |      |     |
| Overdraft, net                                         | (3   | )  | 8    |     |
| Issuance of capital stock, net                         | -    |    | 430  |     |
| Proceeds from issuance of warrants to issue shares     | -    |    | 203  |     |
| Proceeds from loan                                     | 402  |    | 30   |     |
| Repayments of short-term loans                         | -    |    | (158 | )   |
| Net cash provided by financing activities              | 399  |    | 513  |     |
| Increase (decrease) in cash and cash equivalents       | 37   |    | (386 | )   |
| Cash and cash equivalents at the beginning of the year | -    |    | 386  |     |
| Cash and cash equivalents at the end of the year       | \$   | 37 | \$   | -   |
| Non cash transactions                                  |      |    |      |     |
| Conversion of convertible debt to shares               | \$   | 10 | \$   | 221 |

Supplemental  
Disclosure of Cash  
Flow Information:  
Cash paid during the  
period for:

|          |    |    |    |    |
|----------|----|----|----|----|
| Interest | \$ | 28 | \$ | 19 |
|----------|----|----|----|----|

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

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## **SPO MEDICAL INC.**

### **NOTES TO THE FINANCIAL STATEMENTS**

**U.S. dollars in thousands (except share data)**

#### **NOTE 1      GENERAL**

SPO Medical Inc. (hereinafter referred to as "SPO" or the "Company") is engaged in the design, development and marketing of non-invasive pulse oximetry technologies to measure blood oxygen saturation and heart rate. The applications are marketed in the following sectors; professional medical care, homecare, sports, safety and search & rescue.

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

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

The Company and its subsidiary, SPO Ltd., are collectively referred to as the "Company". In January 2010, the Company restructured its operations to focus primarily on licensing its core technology for non-medical market applications. The restructuring included entering into a licensing agreement (the "License") for the then existing medical. PulseOx product line with an entity owned by the Company's then Chief Technology Officer (hereinafter the "Licensee"). Under the terms of the License, the Licensee was granted a non-transferable, royalty bearing license, to

distribute the PulseOx product line and derivatives thereof, for specifically defined medical uses. Following the License, the Company ceased its previous operations associated with the distribution of the PulseOx line in the medical field. In February 2011, the Company transferred research and development activities to subcontractors, thereby ceasing all internal research and development activities.

**NOTE 2      GOING CONCERN**

As reflected in the accompanying financial statements, the Company's operations for the year ended December 31, 2011, resulted in a net loss of \$1,607, and the Company's balance sheet reflects a net stockholders' deficit of \$2,479. The Company's ability to continue operating as a "going concern" is dependent on its ability to raise sufficient additional working capital. These matters raise doubt about the Company's ability to continue as a going concern. The financial statements have been prepared on a going concern basis, which contemplates realization of assets and liquidation of liabilities in the ordinary course of business. As disclosed in previous filings with the Securities and Exchange Commission, management has been attempting to raise additional cash from current and potential stockholders and plans to continue these efforts. There can be no assurance that this capital will be available and if it is not, the Company may be forced to substantially curtail or cease exploration block acquisition and/or exploration and development expenditures. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

### **NOTE 3      SIGNIFICANT ACCOUNTING POLICIES**

The financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") in the United States of America.

#### **A. Principles of Consolidation:**

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, SPO Ltd. All material inter-company accounts and transactions have been eliminated in consolidation.

#### **B. Use of estimates:**

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

#### **C. Financial statements in U.S. dollars:**

The reporting currency of the Company is the U.S. dollar ("dollar"). The dollar is the functional currency of the Company. Transactions and balances originally denominated in dollars are presented at their original amounts. Non-dollar transactions and balances are remeasured into dollars in accordance with the principles set forth in Accounting Standards Codification (ASC) 830-10, "Foreign Currency Translation". All exchange gains and losses from remeasurement of monetary balance sheet items resulting from transactions in non-dollar currencies are recorded in the statement of operations as they arise.

#### **D. Cash and Cash Equivalents:**

The Company considers all highly liquid investments originally purchased with maturities of three months or less to be cash equivalents.

**E. Property and Equipment:**

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, as follows:

|                                   |                            |
|-----------------------------------|----------------------------|
| Computer and peripheral equipment | 3 - 7 years                |
| Office furniture and equipment    | 7 - 15 years               |
| Leasehold improvement             | Over the term of the lease |

In accordance with ASC 360-10, "Accounting for Impairment or Disposal of Long-Lived Assets", management reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable based on estimated future undiscounted cash flows. If so indicated, an impairment loss would be recognized for the difference between the carrying amount of the asset and its fair value. Impairment losses were \$96 and \$0 in the years ended December 31, 2011 and 2010, respectively.

**F. Revenue recognition:**

The company generates revenues principally from licensing its core technology for non-medical market applications. Revenues are recognized when the license fee is fixed and determinable, collectability is reasonably assured.

**G. Research and development costs:**

Research and development costs, net of government grants and participation by others, are charged to expenses as incurred.

**H. Income taxes:**

The Company accounts for income taxes in accordance with ASC 740-10, "Accounting for Income Taxes" This statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

**I. Fair value of financial instruments:**

The financial instruments of the Company consist mainly of cash and cash equivalents, accounts payable and short-term loans. In view of their nature, the fair value of the Company's financial instruments is usually identical or close to their carrying value.

**J. Stock-based compensation:**

Effective January 1, 2006, the Company adopted ASC 718-10, "Share-Based Payment" requiring that compensation cost relating to share-based payment awards made to employees and directors be recognized in the financial statements. The awards issued under Company's stock-based compensation plans are described in Note 10, "Stockholder's Equity". The cost for such awards is measured at the grant date based on the calculated fair value of the award. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods (generally the vesting period of the equity award) in the Company's Consolidated Statement of Operations. The following table summarizes the effects of stock-based compensation resulting from the application of ASC 718-10 included in Statement of Operations:

|                               | Year ended December 31, |       |
|-------------------------------|-------------------------|-------|
|                               | 2011                    | 2010  |
| Research and development, net | \$ -                    | \$ 89 |
| Selling and marketing         | 1,055                   | -     |
| General and administrative    | 139                     | -     |
| Financing                     | 42                      | -     |
| Restructuring expenses        | -                       | 2     |
|                               | \$ 1,236                | \$ 91 |

Share-based compensation cost relating to stock options recognized in 2011 and 2010 is based on the value of the portion of the award that is ultimately expected to vest. ASC 718-10 requires forfeitures to be estimated at the time of grant in order to estimate the portion of the award that will ultimately vest. Such portion is currently estimated at 0%, based on the Company's historical rates of forfeiture.

Under ASC 718-10, the fair market value of option grants was estimated on the date of grant using the "Black-Scholes option pricing" method with the following weighted-average assumptions: (1) expected life of 3 or 5 years (as per option's terms); (2) dividend yield of 0% (3) expected volatility of 273% (4) risk-free interest rate of approximately 0.4% in 2011 and 0.4% in 2010.

**K. Basic and diluted net loss per share:**

Basic and diluted net loss per share is presented in accordance with ASC 260-10, "Earnings Per Share" for all periods presented. Basic and diluted net loss per share of Common Stock was determined by dividing net loss attributable to Common stock holders by weighted average number of shares of Common Stock outstanding during the period.

Diluted net loss per share of Common Stock is the same as basic net loss per share of Common Stock for all periods presented as the effect of the Company's potential additional shares of Common Stock were anti-dilutive.

All outstanding stock options and warrants have been excluded from the calculation of the diluted net loss per share of Common Stock because all such securities are anti-dilutive since the Company reported losses for those years.

**L. Initial adoption of new standards:**

In May 2011, the Financial Accounting Standards Board ("FASB") issued ASU 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards ("IFRSs")." Under ASU 2011-04, the guidance amends certain accounting and disclosure requirements related to fair value measurements to ensure that fair value has the same meaning in U.S. GAAP and in IFRS and that their respective fair value measurement and disclosure requirements are the same. ASU 2011-04 is effective for public entities during interim and annual periods beginning after December 15, 2011. Early adoption is not permitted. The Company does not believe that the adoption of ASU 2011-04 will have a material impact on the Company's results of operation and financial condition.

In June 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income (ASC Topic 220): Presentation of Comprehensive Income," ("ASU 2011-05") which amends current comprehensive income guidance. This accounting update eliminates the option to present the components of other comprehensive income as part of the statement of shareholders' equity. Instead, comprehensive income must be reported in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. ASU 2011-05 will be effective for public companies during the interim and annual periods beginning after Dec. 15, 2011 with early adoption permitted. The Company does not believe that the adoption of ASU 2011-05 will have a material impact on the Company's results of operation and financial condition.

**NOTE 4      PROPERTY AND EQUIPMENT**

|                                   | December 31, |        |
|-----------------------------------|--------------|--------|
|                                   | 2011         | 2010   |
| Cost:                             |              |        |
| Computer and peripheral equipment | \$ -         | \$ 210 |
| Leasehold Improvement             | -            | 31     |
| Office furniture and equipment    | 5            | 26     |
|                                   | \$ 5         | \$ 267 |
| Accumulated depreciation:         |              |        |
| Computer and peripheral equipment | \$ -         | \$ 123 |
| Leasehold Improvement             | -            | 21     |
| Office furniture and equipment    | 5            | 12     |
|                                   | \$ 5         | \$ 156 |
| Property and Equipment, net       | \$ -         | \$ 111 |

Depreciation expenses for the years ended December 31, 2011 and 2010 amounted to \$15 and \$36 respectively.

Following the entry into a License agreement with a Licensee, the Company transferred in January 2010 all property and equipment directly relating to the production of the SPO medical products to the Licensee (cost \$66 and accumulated depreciation \$66, net zero).

Property and equipment presented above are net of impairment charges. The Company determined during 2011 that the events and circumstances indicate that the carrying amounts of its property and equipment may not be recoverable. In accordance with ASC 360-10 Property, Plant and Equipment, the Company tested the recoverability of its property and equipment based, among others, on its business plan and market conditions, and determined that the carrying amounts of its property and equipment may not be recoverable. The Company evaluated the fair value of its property and equipment and determined that the carrying amounts exceed the fair values by \$96. The Company recorded a charge in that amount on a separate line in its 2011 statement of operations.

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## NOTE 5 LOANS PAYABLE

**A.** In December 2005 the Company completed the private placement to certain accredited investors that commenced in April 2005 for the issuance of up to \$1,544 of units of its securities, with each unit comprised of (i) the Company's 18 month 6% promissory note (collectively, the "April 2005 Notes") and (ii) three year warrants to purchase up to such number of shares of the Company's Common Stock as are determined by the principal amount of the Note purchased by such investor divided by \$ 0.85 (collectively the "April 2005 Warrants"). The Company and the holders of \$1,464 in principal amount of the April 2005 Notes subsequently agreed to (a) extend the maturity term of the April 2005 Notes through March 26, 2008, (b) extend the exercise period of the April 2005 Warrants from three to five years with an expiration date of September 26, 2010 and adjust the per share exercise price thereof to \$0.60 and (c) increase the interest rate on the amounts outstanding under the April 2005 Notes to 8% per annum, effective July 12, 2006. Holders of notes in the principal amount of \$125 that have agreed to the extension of the maturity date on the notes, have since exercised their warrants and converted the interest accrued there on into Common Stock; a holder of an April 2005 Notes in the principal amount of \$50 was repaid. The Amendment also provided that if the Company subsequently issue shares of its Common Stock at an effective per share exercise price less than that of the adjusted per share exercise price of the April 2005 Warrants during the adjusted exercise period, then the exercise price thereof is to be reduced to such lower exercise price, except for certain specified issuances. All of the extended notes matured on March 26, 2008.

In March 2008, we offered to the holders of the April 2005 Notes to apply the amounts payable to them on the April 2005 Notes, to the exercise price of the April 2005 Warrants, thereby exercising these warrants, and to convert into Common Stock the accrued interest on the 2005 Notes at a per share conversion price of \$0.60. Note holders who accepted this offer were issued new warrants for such number of shares of Common Stock equal to 25% of the number shares issued to them upon exercise of their existing warrants and conversion of the interest accrued on the note. The new warrants were exercisable over three years at an exercise price of \$0.60. As of December 31, 2009, the holders of approximately \$439 in principal amount have agreed to apply the principal amount owed to them to the exercise price of the April 2005 Warrants. Accordingly, approximately \$520 in amounts owed under the 2005 Notes have been converted into equity and, accordingly, an aggregate of 866,528 shares of our Common Stock have been issued upon exercise of the April 2005 Warrants and conversion of the interest owing on the April 2005 Notes. Under the terms of the offer, new warrants for 216,636 share of our Common stock have been issued to these April 2005 Note holders, exercisable over three years from the date of issuance. We have been informed by the holders of \$300 in principal amount of their election to not accept our offer, of which \$250 of principal and the accrued interest thereon has been repaid as of December 31, 2009. On March 15, 2010, we agreed with the holder of an April 2005 Note in the principal amount of \$50 to extend the note's maturity date to September 15, 2010 and, in consideration thereof, we agreed to pay the holder total amount of \$45, which was paid in full.

On February 5, 2009, the Company agreed with one of the note holders to repay \$25 over a number of payments during the current financial year and to convert accrued interest to 26,500 shares of Common Stock.

On December 31, 2009 the Company and a holder of an April 2005 Notes in the principal amount of \$30 agreed to extend the note's maturity date to December 31, 2011 in consideration of the issuance of warrants to purchase up to 50,000 shares of the of the Company's Common Stock, at a per share exercise price of \$0.01 exercisable for a period of three years.

On May 31, 2010, the Company issued to two note holders of the principal amount of \$200 warrants to purchase up to 600,000 shares of the Company's Common Stock in consideration of such investors' extension to December 31, 2011 of the maturity date of April 2005 Notes held by them and the cancellation of previously issued warrants to purchase up to an aggregate of 333,333 shares of the Company's Common Stock. The warrants are exercisable through December 31, 2013 at a per share exercise price of \$0.15.

On July 27, 2010, the Company issued to two holders of the April 2005 Notes a total of 1,370,000 restricted shares of our Common Stock in satisfaction of a note held by one of the accredited investors in the approximate amount of \$202 and warrants, exercisable through November 15, 2010 to purchase up to 700,000 shares of the Company's Common Stock, at a per share exercise price of \$0.15; on November 15, 2010, warrants for 666,667 shares were exercised for cash proceeds of \$100.

As of December 31, 2011, the outstanding April 2005 Notes principal and accrued interest in the aggregate amount of \$585.

**B.** In July 2006, the Company commenced a private placement of units of its securities, the "Loan Notes", with each unit comprised of (i) the Company's 8% month promissory note due 12 months from the date of issuance and (ii) warrants as described below, pursuant to which the Company raised \$550 (the maximum amount that could be raised from this offering). Under the terms of the offering, the principal and accrued interest was due in one balloon payment at the end of the twelve month period. Each purchaser of the notes received warrants, exercisable over a period of two years from the date of issuance, to purchase 16,250 shares of Common Stock for each \$25 of principal loaned, at a per share exercise price equal to the lower of \$1.50 or 35% less than any offering price at an initial public offering of the Company's Common Stock during the warrant exercise period. During 2007, the Company offered to the holders of the notes to convert the principal and accrued interest into shares of the Company's Common Stock at a per share conversion price of \$0.90. The holders of \$238 of the principal amount agreed to convert the principal and accrued interest thereon into shares of the Company's Common Stock. In 2007, the Company repaid to one note holder the principal amount of \$75 and the accrued interest thereon. On December 31, 2009 the Company and a holder of a Loan Notes in the principal amount of \$150 agreed to extend the note's maturity date to December 31, 2011 in consideration of the issuance of warrants to purchase up to 50,000 shares of the Company's Common Stock, at a per share exercise price of \$0.01 exercisable for a period of three years. On June 30, 2010, the company issued 105,074 restricted shares of our Common Stock to a note holder in satisfaction of \$16 owed to such holder and the cancellation of previously issued warrants to purchase up to 7,800 shares of the Company's Common Stock.

As of December 31, 2011, approximately \$161 in respect of the principal and accrued interest on these notes remains outstanding.

**C.** On December 29, 2010, the Company and its Chief Executive Officer entered into a loan agreement pursuant to which the Chief Executive Officer loaned to the Company \$30 for working capital purposes. The original maturity date of the loan was January 29, 2011. The loan bears interest at a per annum rate of 8%. In January 2011, the maturity date of the loan was extended to April 30, 2011.

On March 25, 2011, we and one of our stockholders entered into a loan agreement pursuant to which the stockholder loaned to the Company \$50 for working capital purposes. The original maturity date of the loan is March 25, 2012. The loan bears interest at a per annum rate of 8%.

In May 2011, we entered into a Securities Purchase Agreement with an investor pursuant to which we issued an 8% convertible promissory note in the principal amount of \$50 that is convertible into shares of our Common Stock. The loan, together with accrued interest, is scheduled to mature in May 2012. Commencing November 4, 2011, the Investor is entitled to convert all or any part of the outstanding and unpaid principal amount on the note, as well as the interest accrued, into shares of the Company's Common Stock at a conversion rate equal to 55% of the average of the

five lowest closing sale prices during the ten days preceding the conversion date. For financial reporting purposes, the conversion feature was recorded in short term liabilities at its fair value of \$41. Accordingly, the company recorded a discount of \$41 on the convertible promissory note to be amortized through November 4 2011.

In December 2011, the investor converted a promissory note into equity in the principal amount of \$10.

As of December 31, 2011, the outstanding convertible promissory note's principal and conversion feature and accrued interest in the aggregate amounted to \$75.

On May 18, 2011 the Company and an investor signed a Term Sheet regarding an Equity line of credit which was consummated via an Investment Agreement signed on July 7, 2011. According to the Investment Agreement the investor committed to purchase, subject to certain restrictions and conditions, up to \$5 million of the Company's common stock, par value \$0.01 per share over a period of 36 months from the first trading day following the effectiveness of the registration statement registering the resale of shares purchased by the investor pursuant to the Investment Agreement. Pursuant to the terms of a Registration Rights Agreement dated as of July 5, 2011 between the Company and the investor, the Company is obligated to file, by September 5, 2011, a registration statement with the Securities and Exchange Commission to register the resale by the investor of the shares of common stock issued or issuable under the Investment Agreement. The Company is required to initially register 10,000,000 shares of common stock. The Company is obligated to use all commercially reasonable efforts to have the registration statement declared effective within 90 days after the filing. In connection with the Investment Agreement, the Company issued 166,666 shares of its Common Stock as a document preparation fee. As of April 5, 2012 the Company has not filed this registration statement.

In June 2011, we received from an investor net proceeds of \$25 in consideration for the purchase of shares of our Common Stock. In connection therewith, in June 2011, the Company issued to the investor 166,667 shares of the Company's Common Stock.

In August and November, 2011, we received \$75 and \$200 from existing investors on account for loans. The loans are scheduled to mature in August and November 2013 and bear interest at the rate of 10% per annum. Principal and accrued interest is convertible into shares of our common stock at the option of the holder at the conversion price of \$0.15 per share. In January 2012 the Company issued to the investor warrants, exercisable through August and November, 2015, to purchase, in the aggregate, up to 916,668 shares of our common stock at a per share exercise price of \$0.15.

#### **NOTE 6 EMPLOYEES AND PAYROLL ACCRUALS**

The Company recorded liability to its employees in respect of unpaid salaries and employment benefits, which also includes accruals for salaries and benefits thereon that have been deferred since July 2008. On July 15, 2010, the Company issued to part of the employees three year warrants to purchase up to 345,000 shares of the Company's Common Stock at a per share exercise price of \$0.01 in consideration of the waiver by such employees of amounts payable to them. As of December 31, 2011, the Company's liability to its employees in respect of unpaid salaries aggregated \$439.

#### **NOTE 7 ACCRUED EXPENSES AND OTHER LIABILITIES**

|                                                | December 31, |        |
|------------------------------------------------|--------------|--------|
|                                                | 2011         | 2010   |
| Royalties to the office of the Chief Scientist | \$ 386       | \$ 416 |
| Liability results from re-organization         | -            | 6      |
| Other accrued expenses                         | 245          | 199    |
|                                                | \$ 631       | \$ 621 |

#### **NOTE 8 ACCRUED SEVERANCE PAY**

The Company's liability for severance pay is calculated in accordance with Israeli law based on the most recent salary paid to employees and the length of employment in the Company. The Company's liability for severance pay has been fully provided for. Part of the liability is funded through individual insurance policies. These policies are assets of the Company and under labor agreements, subject to certain limitations, they may be transferred to the ownership of the beneficiary employees. Severance pay income for the year ended December 31, 2011 and 2010 amounted to \$41 and \$21 respectively due to settlements with former employees.

## **NOTE 9 PRIVATE PLACEMENTS**

### **A. Issuance of Common Stock**

- a. On February 5, 2009 the Company issued to one of the note holders 26,500 shares of its Common Stock.
- b. In March and July 2009, the Company issued to a consultant 50,000 and 200,000 shares of Common Stock, respectively, at per share purchase price of \$0.01 in respect of an agreement with the consultant for financial advisory services.

- c. In August 2009, the Company entered into an agreement with a service provider for investor relations services. Under the terms of the agreement, the service provider received 150,000 shares of Common Stock, at per share purchase price of \$0.01.
- d. In February and April 2010, pursuant to the terms of a financial advisory services agreement, the Company issued to a consultant 300,000 and 150,000 shares, respectively, of its Common Stock, at per share purchase price of \$0.01.
- e. On June 30, 2010, the Company issued 100,000 restricted shares of its Common Stock to one accredited investor pursuant to the terms of a consulting agreement for the provision of financial services.
- f. On June 30, 2010, the Company issued one of the note holders 105,074 restricted shares of its Common Stock.
- g. On each of July 27, 2010 and November 15, 2010, the Company issued 1,370,000 and 666,667, respectively, shares of its Common Stock to two accredited investors.
- h. On July 29, 2010, the Company entered into a Subscription Agreement with eight accredited investors (the "Investors"), pursuant to which the Company sold and issued to the Investors (the "Private Placement") an aggregate of 14.61 units of the Company's securities described below (the "Units") at a purchase price of \$30 per Unit, for aggregate gross proceeds of \$438

On September 16, 2010, the Company entered into a Subscription Agreement with an additional eight accredited Investors, pursuant to which the Company sold and issued to these Investors an aggregate of 6.016 Units at the per Unit price of \$30 in a second closing of its Private Placement, for aggregate gross proceeds of \$181.

Each Unit is comprised of (i) 200,000 shares of the Company's Common Stock, and (ii) a three-year warrant (the "Investor Warrant") to purchase 100,000 shares of the Company's Common Stock at a per share exercise price of \$0.25 per share.

A total of 4,125,667 shares of Common Stock were issued pursuant to the two closings described above. In addition, Investor Warrants to purchase a total of 2,062,833 shares of Common Stock at the exercise price of \$0.25 per share were issued pursuant to such closings. The Private Placement terminated on October 13, 2010.

The Company received net proceeds of \$529 after payment of \$90 of cash commissions and an expense allowance to the placement agent of the Private Placement (the “Placement Agent”) and other offering expenses and related costs in connection with the Private Placement. In addition, the Company issued to the Placement Agent three-year warrants to purchase an aggregate of 742,626 shares of the Company’s Common Stock, of which warrants for 495,080 shares are at an exercise price of \$0.15 per share and warrants for 247,546 shares are at an exercise price of \$0.25 per share. The warrants issued to the Placement Agent are referred to in this report collectively as the “Agent Warrants.”

The Investor Warrants and Agent Warrants may be exercised in cash or pursuant to a net exercise provision if on or after the six month anniversary of issuance if there is not an effective registration statement relating to the resale of the shares of Common Stock and the share of Common Stock issuable upon exercise of the Investor Warrants and the Agent Warrants. The exercise price of the Investor Warrants and the Agent Warrants is subject to adjustment for stock splits, stock dividends, recapitalizations and also provide for certain price protection anti-dilution provisions in the event of future issuances of Common Stock or Common Stock equivalents at less than \$0.15 per share (subject to certain customary exceptions). The Investor Warrants and Agent Warrants also are subject to a blocker that would prevent each holder’s Common Stock ownership at any given time from exceeding 4.999% of the Company’s outstanding Common Stock, which provision may be waived by the holder on 61 days prior written notice.

The Company treated the issuance of the warrants mentioned above in accordance with ASC 815-40 Contracts in Entity's Own Equity. The Company determined that the warrants are considered derivatives and should be classified as liabilities carried at fair value through profit and loss. The reason for that classification is that the exercise price of the warrants may be adjusted in response to changes in variables not considered to be inputs to the fair value of a fixed-for-fixed option on equity shares.

i In August 2010, the Company entered into an agreement with a service provider for the provision to it of public relations services. Under the terms of the agreement the service provider received 75,000 shares of Common Stock.

j. On October 8, 2010 and November 4, 2010 the Company issued 46,925 and 360,000, respectively, shares of Common Stock upon the exercise by service providers of warrants previously issued to them.

On January 25, 2011, the Company issued 200,000 shares of the Company's Common Stock to a consultant in connection with consulting services provided by such consultant. On July 28, 2011, the Company issued an additional 25,000 shares of the Company's Common Stock to such consultant in respect of ongoing services.

In February and March, 2011, the Company issued 500,000 shares of the Company's Common Stock to a consultant in connection with investor relations services.

On May 18, 2011 the Company and an investor signed a Term Sheet regarding an Equity line of credit which was consummated via an Investment Agreement signed on July 7, 2011. According to the Investment Agreement the investor committed to purchase, subject to certain restrictions and conditions, up to \$5,000 of the Company's common stock, par value \$0.01 per share over a period of 36 months from the first trading day following the effectiveness of the registration statement registering the resale of shares purchased by the investor pursuant to the Investment Agreement. Pursuant to the terms of a Registration Rights Agreement dated as of July 5, 2011 between the Company and the investor, the Company was obligated to file, by September 5, 2011, a registration statement with the Securities and Exchange Commission to register the resale by the investor of the shares of common stock issued or issuable under the Investment Agreement. The Company was required to initially register 10,000,000 shares of common stock, and to use all commercially reasonable efforts to have the registration statement declared effective within 90 days after the filing. In connection with the Investment Agreement, the Company issued 166,666 shares of its Common Stock as a document preparation fee. As of the date of the filing of this annual report on Form 10-K, the Company has not filed the registration statement.

On June 1, 2011, the Company received from an investor net proceeds of \$25 in consideration for the purchase of shares of the Company's Common Stock. In connection therewith, in June 2011, the Company issued to the investor 166,667 shares of the Company's Common Stock.

During the year ended December 31, 2011, warrants with an exercise price of \$0.01 were exercised for 125,000 of the Company's shares of Common Stock.

On December 13, 2011, the Company issued 1,500,000 shares of the Company's Common Stock to a consultant in connection with consulting services provided by such consultant.

On December 31, 2011, the Company agreed to issue 250,000 shares to the former Financial Controller of the Company to settle all amounts owed to the Financial Controller.

**B. Issuance of Warrants**

a. On May 31, 2010, the Company issued to two accredited investors warrants to purchase up to 600,000 shares of its Common Stock.

b. On July 1, 2010, the Company agreed to issue 5,000,000 restricted shares of its Common Stock to one accredited investor pursuant to the terms of a consulting agreement for the provision of public relations, promotion and marketing services geared to the recreational sports and wellness market. On July 6, 2010, the Company and the investor amended the agreement such that in lieu of the issuance of the 5,000,000 restricted shares, the Company issued to such investor warrants, exercisable through June 30, 2015, to purchase up to 5,000,000 shares of Common Stock at a per share exercise price of \$0.01.

c. On July 1, 2010, the Company issued to a Non-U.S. person warrants to purchase up to 3,800,000 shares of the Company's Common Stock pursuant to the terms of a development and marketing agreement for the provision of services relating to the development, launching and marketing of the Company's products and technologies to the wellness and recreational sports market. The warrants are exercisable through June 30, 2015 at a per share price of \$0.01, as follows: commencing on August 1, 2010 and continuing through July 2011, the warrants are exercisable for up to 320,000 shares of Common Stock on the first trading day of each month and, on August 1, 2011, for 280,000 shares.

d. On July 15, 2010, the Company issued to the employees of its subsidiary, SPO Medical Ltd, three year warrants to purchase up to 345,000 shares of the Company's Common Stock at a per share exercise price of \$0.01 in consideration of the waiver by such employees of money payable to them.

e. On September 6, 2010, the Company issued to a consultant in connection with investor relations, PR and marketing activities, five year warrants to purchase up to 250,000 shares of Common Stock exercisable at a per share exercise price of \$0.01 and a three year warrants to purchase up to 150,000, scheduled to vest in equal installments of 18,750 shares at the end of each three month period at a per share exercise price of \$0.15.

f. During the year ended December 31, 2011 the Company issued warrants to a service provider to purchase 83,334 shares at an exercise price of \$0.15, exercisable through May 2014.

g. Warrants issued in conjunction with the July 29, 2010 offering were accounted for as derivative liabilities. The fair value of the warrants at December 31, 2011 was calculated using Black-Scholes and the following assumptions, estimated life of 1.58 to 1.71 years remaining, volatility of 304% to 313%, risk free interest rate of 0.25%, and dividend yield of 0%.

## **NOTE 10 STOCKHOLDER'S DEFECIENCY**

### **A. Authorized Shares**

On July 12, 2010, the Company's Board of Directors authorized an increase of the number of shares of Common Stock from 50,000,000 to 100,000,000 and the majority of Company's stockholders approved such increase on July 13, 2010. The increase became effective as of October 4, 2010.

The Company's Board of Directors is authorized to issue from time to time up to 2 million shares of preferred stock in one or more series, and to fix for each such series such voting power and such designations, preferences, relative participating or other rights, redemption rights, conversion privileges and such qualifications or restrictions thereof as shall be adopted by the board and set forth in an amendment to the Company's Certificate of Incorporation. Unless a vote of any shareholders is required pursuant to the rights of the holders of preferred stock then outstanding, the board may from time to time increase or decrease (but not below the number of shares of such series outstanding) the number of shares of any series of Preferred Stock subsequent to the issuance of shares of that series.

## **B. Equity Incentive Plans**

In April 2005, the Company adopted the 2005 Equity Incentive Plan (the "2005 Plan"). A total of 1.75 million shares of Common Stock were originally reserved for issuance under the 2005 Plan. The 2005 Plan provides for the grant of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, bonus stock, awards in lieu of cash obligations, other stock-based awards and performance units. The 2005 Plan also permits cash payments under certain conditions. The compensation committee of the Board of Directors is responsible for determining the type of award, when and to who awards are granted, the number of shares and the terms of the awards and exercise prices. The options are exercisable for a period not to exceed ten years from the date of grant. Vesting periods range from immediately to four years. Under the 2005 plan options granted expire no later than the tenth anniversary from the date of the grant.

In April 2005, the Company adopted the 2005 Non-Employee Directors Stock Option Plan (the "2005 Directors Plan") providing for the issuance of up to 400,000 shares of Common Stock to non-employee directors. Under the 2005 Directors Plan, only non-qualified options may be issued and they will be exercisable for a period of up to six years from the date of grant.

With respect to compensation expenses recorded in 2011 and 2010, relating to options granted through December 31 2011, the Company applied the provisions of ASC 718-10, which require employee share-based equity awards to be accounted for under the fair value method, ASC 718-10 requires the use of an option pricing model for estimating fair value, which is then amortized to expense over the service periods.

During 2011 and 2010 the Company recorded Stock-based compensation expenses in the amount of \$1,236 and \$91, respectively.

### C. Stock Options:

As of December 31, 2011, options for an aggregate of 130,000 shares of Common Stock remain available for future grants under the Company's 2005 Plan and 2005 Directors Plan.

|                                            | December 31, 2011 |                                |
|--------------------------------------------|-------------------|--------------------------------|
|                                            | Amount of Options | Weighed Average Exercise Price |
| Outstanding at the beginning of the year * | 1,820,000         | \$ 0.42                        |
| Forfeited                                  | (140,000 )        | 0.05                           |
| Outstanding at the end of the year         | 1,680,000         | \$ 0.43                        |
| Exercisable at the end of the year         | 1,680,000         | \$ 0.43                        |

\* Of which 50,000 options granted to non-executive directors were re-priced during 2008

The options outstanding as of December 31, 2011, have been separated into ranges of exercise price as follows:

| Range of exercise price | Options outstanding as of December 31, 2011 | Weighted average remaining contractual life (years) | Weighted average exercise price | Options exercisable as of December 31, 2011 | Weighted average exercise price of options exercisable |
|-------------------------|---------------------------------------------|-----------------------------------------------------|---------------------------------|---------------------------------------------|--------------------------------------------------------|
| \$ 0.13-0.15            | 937,000                                     | 5.02                                                | \$ 0.13                         | 937,000                                     | \$ 0.13                                                |
| \$ 0.60                 | 483,000                                     | 3.73                                                | \$ 0.60                         | 483,000                                     | \$ 0.60                                                |
| \$ 0.78                 | 100,000                                     | 3.00                                                | \$ 0.78                         | 100,000                                     | \$ 0.78                                                |
| \$ 0.85                 | 60,000                                      | 4.39                                                | \$ 0.85                         | 60,000                                      | \$ 0.85                                                |
| \$ 1.85                 | 100,000                                     | 4.80                                                | \$ 1.85                         | 100,000                                     | \$ 1.85                                                |
|                         | 1,680,000                                   | 4.50                                                | \$ 0.43                         | 1,680,000                                   | \$ 0.43                                                |

#### D. Stock warrants

The Company has the following warrants outstanding:

| Issuance date | number of warrants issued | Exercise price | Exercisable as of December 31, 2011 | Exercisable through          |
|---------------|---------------------------|----------------|-------------------------------------|------------------------------|
| 2005-2010 (1) | 10,422,383                | 0.01           | 10,422,383                          | December 2012-September 2015 |
| 2009 (2)      | 100,000                   | 0.80           | 100,000                             | December 2014                |
| 2010-2011 (3) | 1,215,914                 | 0.15           | 1,215,914                           | July- May 2014               |
| 2010 (4)      | 2,310,379                 | 0.25           | 2,310,379                           | July -September 2013         |
| 2009 (5)      | 216,636                   | 0.60           | 216,636                             | December 2012                |

- (1) Penny warrants issued to employees 345,000, service providers 9,431,000, and ex-employees 646,383.
- (2) Warrants issued to directors in lieu of outstanding fees owed to them.
- (3) 600,000 warrants issued to lenders in return for extension of the their loans, 37,500 to a service provider and 578,414 warrants issued in connection with capital raise during 2010 and 2011 (see also Note 9)
- (4) warrants issued in connection with capital raise during 2010 (see also Note 9)
- (5) Warrants Issued to a service provider

## E. Dividends

The Company does not intend to pay cash dividends in the foreseeable future.

## NOTE 11 RESEARCH AND DEVELOPMENT EXPENSES, NET

Research and development expenses consist of the following:

|                                                                       | December 31, |        |
|-----------------------------------------------------------------------|--------------|--------|
|                                                                       | 2011         | 2010   |
| Research and development expenses                                     | \$ 57        | \$ 372 |
| Grants from Office of the Chief Scientist of the Government of Israel | -            | (70 )  |
| Research and development expenses, net                                | \$ 57        | \$ 302 |

## NOTE 12 RESTRUCTURING EXPENSES AND RESTRUCTURING OF DEBT INCOME

In January 2010, the Company completed a restructuring plan in an attempt to focus primarily on licensing its core technology for non-medical market applications. The restructuring plan included a reduction of the Company's corporate and manufacturing workforce and entering into an alliance and license agreement.

In December 2009 the Company reached an understanding with its non-executive directors pursuant to which the outstanding directors fees owing to such persons was waived in consideration of the issuance to them of warrants to purchase, in the aggregate, 100,000 shares of the Company's Common Stock. The warrants are exercisable through January 17, 2015 and have a per share exercise price of \$0.08.

At December 31, 2009, the Company decided to write off \$262 of debt that had aged in excess of seven years that was originally recorded following the Company's reverse merger with United Diagnostics in 2005.

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**NOTE 13 FINANCIAL INCOME (EXPENSE)**

Financial income (expense) are comprised of the following:

|                                                                                                                                                                    | 2011     | 2010      |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|-----------|
| Non cash amortization of warrants granted to loaners in return for extension of the their loans and issuance of shares to financial service provider               | \$ (12 ) | \$ (172 ) |
| Non-cash financial expenses related to warrants to issue shares                                                                                                    | 200      | (16 )     |
| interest in respect of debt instruments and amortization of deferred interest                                                                                      | (123 )   | (19 )     |
| Exchange rate differences caused by fluctuations in the exchange rate with the New Israeli Shekel ("NIS") on liabilities denominated in NIS held by the subsidiary | 138      | (92 )     |
| Other                                                                                                                                                              | (3 )     | -         |
|                                                                                                                                                                    | \$ 200   | \$ (299 ) |

**NOTE 14 DEFERRED TAXES**

**A.** Measurement of taxable income under the Income Tax Law (Inflationary Adjustments), 1985:

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The results for tax purposes of the Israeli subsidiary are measured in terms of earnings in NIS. As explained in Note 3C, the functional currency is the U.S. dollar., The Company has not provided deferred income taxes on the difference between the functional currency and the tax bases of assets and liabilities at the Israeli subsidiary.

**B.** Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

In accordance with ASC 740-10, the components of deferred income taxes are as follows:

|                                          | December 31, |         |
|------------------------------------------|--------------|---------|
|                                          | 2011         | 2010    |
| Tax on net operating losses carryforward | \$7,334      | \$4,940 |
| Less - valuation allowance               | (7,334)      | (4,940) |
|                                          | \$-          | \$-     |

**C.** The Company has provided valuation allowances in respect of deferred tax assets resulting from tax loss carryforward and other temporary differences. Management currently believes that since the Company has a history of losses it is more likely than not that the deferred tax regarding the loss carryforward and other temporary differences will not be realized in the foreseeable future.

Net operating loss carryforwards as of December 31, 2011 and 2010 are as follows:

|        | December 31, |          |
|--------|--------------|----------|
|        | 2011         | 2010     |
| Israel | \$3,671      | \$1,839  |
| USA    | 18,334       | 17,920   |
| Total  | \$22,005     | \$19,759 |

Net operating losses in Israel may be carried forward indefinitely. Net operating losses in the U.S. are available through 2031.



## **NOTE 15      COMMITMENTS AND CONTINGENCIES**

### **Government of Israel**

The Company's wholly owned subsidiary, SPO Ltd., is committed to pay royalties to the Office of the Chief Scientist of the Government of Israel ("OCS") on sales of products, the research and development of which the OCS has participated in by way of grants, up to the amount of 100%-150% of the grants received plus interest at dollar LIBOR. The royalties are payable at a rate of 3% for the first three years of product sales and 3.5% thereafter. The total amount of grants received or accrued, net of royalties paid or accrued, as of December 31, 2011 was \$1.3 million. The refund of the grants is contingent upon the successful outcome of the research and development and the attainment of sales. The Company has no obligation to refund these grants, if sales are not generated. The financial risk is assumed completely by the OCS. The grants were received from the OCS on a project-by-project basis. If the project fails the Company has no obligation to repay any grant received for the specific unsuccessful or aborted project. As of December 31, 2011 the Company has provided for \$386 (2010 - \$416) in royalties from sales of its products. Owing to the current financial situation of the Company, the Company has deferred these payments under an informal agreement with the OCS.

## **NOTE 16      SUBSEQUENT EVENTS**

In January 2012 the Company issued warrants to investors, exercisable through October 30, 2015, to purchase, in the aggregate, up to 916,668 shares of our common stock at a per share exercise price of \$0.15

On February 7, 2012, the Company entered into a convertible note agreement pursuant to which the Company received \$50,000. The original maturity date of the note is February 7, 2013. The note bears interest at a per annum rate of 8%.

On March 22, 2012, the Company entered into two convertible note agreements with investors pursuant to which the Company received a total of \$50,000. The original maturity date of the notes is September 22, 2012. The notes bear interest at a per annum rate of 20%. The Notes and accrued interest are convertible to common stock of the Company at a conversion rate of \$0.08 per share.