SCHWEITZER MAUDUIT INTERNATIONAL INC
Form 11-K
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Audit Related Fees

$

—

—

Tax Fees

$

3,500

$

6,500

All Other Fees

$

60,000

—

Total

$

102,000

$

45,500

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.

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SIGNATURES

In accordance with the requirements of the Exchange Act the issuer caused this report to be signed by the undersigned thereunto duly authorized.

DATE: March 21, 2008

/s/ Michael Braunold
Michael Braunold
Chief Executive Officer and Director

DATE: March 21, 2008

/s/ Jeff Feuer
Jeff Feuer
Chief Financial Officer
(Principal financial and accounting officer)

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 Sidney Braun	Chairman, Director	March 21, 2008
/s/ Michael Braunold Michael Braunold	President, Chief Executive Officer and Director	March 21, 2008
/s/ Pauline Dorfman Pauline Dorfman	Director	March 21, 2008

SPO MEDICAL INC. AND ITS SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2007

U.S. DOLLARS IN THOUSANDS

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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 sheet of SPO MEDICAL INC. ("the Company") and its subsidiary as of December 31, 2007, and the related statements of operations, changes in stockholders' deficiency and cash flows for each of the two years in the period ended December 31, 2007. 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 audit 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 audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and its subsidiary as of December 31, 2007, and the consolidated results of their operations and their cash flows for each of the two years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

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 has incurred recurring losses from operations and has a shareholders' deficiency that raises 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.

Brightman Almagor & Co.
Certified Public Accountants
A member firm of Deloitte Touche Tohmatsu

/s/ Brightman Almagor & Co.
Tel-Aviv, Israel
March 19, 2008

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

	Note		December 31, 2007
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents		$	1,242
Trade receivables			883
Prepaid expenses and other accounts receivable			120
Inventories	4		1,081
			3,326
LONG TERM INVESTMENTS			
Deposits			15
Severance pay fund			313
			328
PROPERTY AND EQUIPMENT, NET	5		177
Total net assets		$	3,831

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

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

	Note		December 31, 2007
LIABILITIES AND STOCKHOLDERS' DEFICIENCY			
Current Liabilities			
Short-term loans, net	6	$	1,814
Trade payables			576
Employees and Payroll accruals			294
Other creditors	8		485
Accrued expenses and other liabilities	9		750
			3,919
Long-Term Liabilities			
Accrued severance pay	10		446
COMMITMENTS AND CONTINGENT LIABILITIES	14		
STOCKHOLDERS' DEFICIENCY			
Stock capital	11		
Preferred stock of $0.01 par value			
Authorized - 2,000,000 shares, issued and outstanding - none			
Common stock $0.01 par value-			
Authorized - 50,000,000 shares, issued and outstanding - 21,510,188 shares			215
Additional paid-in capital			11,904
Accumulated deficit			(12,653)
			(534)
Total liabilities and stockholders' deficiency		$	3,831

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	
	2007	**2006**
Revenues	$ 5,008	$ 3,714
Cost of revenues	2,447	1,809
Gross profit	2,561	1,905
Operating expenses		
Research and development	1,198	972
Selling and marketing	675	671
General and administrative	1,450	923
Total operating expenses	3,323	2,566
Operating loss	762	661
Financial expenses, net	842	4,302
Net Loss for the year	$ 1,604	$ 4,963
Basic and diluted loss per ordinary share	$ 0.08	$ 0.26
Weighted average number of shares outstanding used in computation of basic and diluted loss per share	21,099,367	19,069,380

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

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

	Share capital	Additional paid-in capital	Deferred compensation	Accumulated deficit	Total
Balance as of January 1, 2006	$ 170	$ 4,833	$ (227)	$ (6,086)	$ (1,310)
Deferred compensation reclassified due to FAS 123R implementation for the first time		(227)	227		—
Warrants issued in connection with loans		530			530
Amortization of deferred stock-based compensation related to options granted to consultants		893			893
Exercise of warrants by external consultant	5				5
Benefit resulting from changes to warrant terms		2,534			2,534
Exercise of convertible notes	9	560			569
Amortization of deferred stock-based compensation related to options granted to employees		189			189
Amortization of deferred stock-based compensation related to options granted to directors		71			71
Issuance of ordinary shares	9	571			580
Net Loss				(4,963)	(4,963)
Balance as of December 31, 2006	$ 193	$ 9,954	$ —	$ (11,049)	$ (902)
Issuance of stock capital, net	14	1,169			1,183
Exercise of stock options	2	8			10
Warrants issued in connection with credit line		19			19
Benefit resulting from changes to warrant terms		41			41
Issuance of ordinary shares upon exercise of warrants and conversion of loans	6	510			516
Amortization of deferred stock-based compensation related to options granted to employees		110			110
Amortization of deferred stock-based compensation related to options granted to directors		58			58
Amortization of deferred stock-based compensation related to options granted to consultants		35			35
Net Loss				(1,604)	(1,604)

Balance as of December 31, 2007	$ 215	$ 11,904	$ —	$ (12,653)	$ (534)

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, 2007	2006
Cash Flows from Operating Activities		
Net Loss for the period	$ (1,604)	$ (4,963)
Adjustments to reconcile loss to net cash used in operating activities:		
Depreciation	31	24
Stock-based compensation expenses	224	1,152
Amortization of loan discounts	491	814
Increase in accrued interest payable on loans	154	156
Loan commission	—	20
Benefit resulting from changes to warrant terms	41	2,534
Revaluation of loans	112	
Changes in assets and liabilities:		
Increase in trade receivables	(315)	(369)
Decrease (Increase) in prepaid expenses and other receivables	130	(208)
Increase in inventories	(270)	(351)
Increase in accounts payable	88	263
Increase (decrease) in accrued severance pay, net	11	(7)
Increase in other creditors	90	395
Increase in accrued expenses and other liabilities	258	97
Net cash used in operating activities	(559)	(443)
Cash Flows from Investing Activities		
Increase in long-term deposits	(4)	(1)
Sale of property and equipment	1	—
Purchase of property and equipment	(103)	(82)
Net cash used in investing activities	(106)	(83)
Cash Flows from Financing Activities		
Issuance of stock capital	1,183	580
Exercise of warrants by consultant	—	5
Receipt of short-term loans	—	152
Proceeds on issuance of exercisable warrants	—	528
Issuance of stock capital upon exercise of options	10	—
Repayment of short-term loans	(122)	(396)
Net cash provided by financing activities	1,071	869
Increase in cash and cash equivalents	406	343
Cash and cash equivalents at the beginning of the year	836	493
Cash and cash equivalents at the end of the period	$ 1,242	$ 836
Non cash transactions		
Conversion of convertible notes	$ —	$ 569
Conversion of loan notes into stock capital	$ 368	$

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

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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; homecare, professional medical care, 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".

NOTE 2 - GOING CONCERN

As reflected in these financial statements, the Company’s operations for the year ended December 31, 2007, resulted in a net loss of $1,604 and the Company’s balance sheet reflects a net stockholders’ deficit of $534. The Company’s ability to continue operating as a “going concern” is dependent on its ability to raise sufficient additional working capital. Management’s plans in this regard include raising additional cash from current and potential stockholders and increasing the marketing of its current and new products.

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 Statement of Financial Accounting Standards ("SFAS") No. 52 "Foreign Currency Translation" ("SFAS No. 52"). 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 SFAS No. 144, "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. As of December 31, 2007, no impairment losses have been recorded.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

F. Revenue recognition:

The Company generates its revenues mainly from sales of its products. Revenues are recognized when delivery has occurred, persuasive evidence of an arrangement exists, the vendor’s fee is fixed or determinable, no further obligation exists, collection is probable and there are no remaining significant obligations. Delivery is considered to have occurred upon shipment from the Company’s distribution centers to the reseller. All of the Company’s products that are sold through reseller agreements are non-exchangeable, non refundable and non returnable. Accordingly the resellers are considered end users.

G. Inventory:

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

H. Research and development costs:

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

I. Income taxes:

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). 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.

J. Fair value of financial instruments:

The financial instruments of the Company consist mainly of cash and cash equivalents, short-term investments, trade receivables, 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.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

K. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents. The majority of the Company's cash and cash equivalents are invested in US dollar deposits. Management believes that the financial institutions that hold the Company's investments are financially sound, and accordingly, minimal credit risk exists with respect to these investments.

L. Stock-based compensation:

Effective January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R) 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 13, "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 SFAS No. 123 (revised 2004) included in Statement of Operations:

	Year ended December 31, 2007	Year ended December 31, 2006
Cost of revenues	$ 7	$ 13
Research and development, net	21	176
Selling and marketing	48	99
General and administrative	127	122
	$ 203	$ 410

Share-based compensation cost relating to stock options recognized in 2006 and 2007 is based on the value of the portion of the award that is ultimately expected to vest. SFAS No. 123R 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 SFAS 123, 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 3.5 or 10 years (as per option's terms); (2) dividend yield of 0% (3) expected volatility of 100% and (4) risk-free interest rate of approximately 4.5%.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

M. Effects of recently issued accounting standards:

(1) In September 2006, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 157, “Fair Value Measurements” (SFAS No. 157). The purpose of SFAS No. 157 is to define fair value, establish a framework for measuring fair value, and enhance disclosures about fair value measurements. The measurement and disclosure requirements are effective for the Company beginning in the first quarter of fiscal year 2008. In February, 2008, the FASB issued Staff Position (“FSP”) FAS 157-2, which delays the effective date of FAS 157 for all non-financial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements. As applicable to the Company, FAS 157, except as it relates to non-financial assets and liabilities as noted in proposed FSP FAS 157-2, will be effective as of the year beginning January 1, 2008.The adoption of SFAS No. 157 is not expected to have a significant impact on the Company’s consolidated financial statements.

(2) In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (SFAS No. 159). SFAS No. 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS No. 159 is effective for the Company beginning in the first quarter of fiscal year 2008, although earlier adoption is permitted. The adoption of SFAS No. 159 is not expected to have a significant impact on the Company’s consolidated financial statements.

(3) In June 2007, the FASB ratified Emerging Issues Task Force (EITF) Issue No. 07-3, “Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities” (EITF 07-3). EITF 07-3 requires non-refundable advance payments for goods and services to be used in future research and development activities to be recorded as an asset and the payments to be expensed when the research and development activities are performed. EITF 07-3 applies prospectively for new contractual arrangements entered into beginning in the first quarter of fiscal year 2008. The Company currently recognizes these non-refundable advanced payments as an expense upon payment. The adoption of EITF 07-3 is not expected to have a significant impact on the Company's consolidated financial statements.

(4) In December 2007, the FASB issued SFAS No. 141(R) “Business Combinations” (“SFAS 141(R)”) and SFAS No. 160, “Non-controlling Interests in Consolidated Financial Statement” (“SFAS 160”). SFAS 141(R) requires the acquiring entity in a business combination to record all assets acquired and liabilities assumed at their respective acquisition-date fair values and changes other practices under FAS 141, some of which could have a material impact on how the Company accounts for business combinations. SFAS 141(R) also requires additional disclosure of information surrounding a business combination, such that users of the entity’s financial statements can fully understand the nature and financial impact of the business combination. SFAS 160 requires entities to report non-controlling (minority) interests in subsidiaries as equity in the consolidated financial statements. The Company is required to adopt SFAS 141(R) and SFAS 160 simultaneously in its fiscal year beginning November 1, 2009. The provisions of SFAS 141(R) will only impact the Company if it is a party to a business combination after the pronouncement has been adopted. The adoption of SFAS 141(R) and SFAS 160 is not expected to have a significant impact on the Company’s consolidated financial statements.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

N. Basic and diluted net loss per share:

Basic and diluted net loss per share is presented in accordance with Statement of Accounting Financial Standards No. 128, "Earnings Per Share" ("SFAS No. 128") 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. The total number of shares related to the outstanding options and warrants excluded from the calculations of diluted net loss per share, was 4,562,100 and 5,472,838 for the years ended December 31, 2007 and 2006, respectively.

NOTE 4 - INVENTORIES

		December 31, 2007
Raw Materials	$	771
Work In Process		77
Finished Goods		233
	$	1,081

NOTE 5 - PROPERTY AND EQUIPMENT

		December 31, 2007
Cost:		
Computer and peripheral equipment	$	216
Leasehold Improvement		31
Office furniture and equipment		28
	$	275
Accumulated depreciation:		
Computer and peripheral equipment	$	86
Leasehold Improvement		2
Office furniture and equipment		10
	$	98
Property and Equipment, net	$	177

Depreciation expenses for the years ended December 31, 2007 and 2006 amounted to $31 and $24 respectively.

NOTE 6 - SHORT-TERM LOANS

A. In December 2005 the Company completed a private placement to certain accredited investors that it commenced in April 2005 for the issuance of up to $1,544 of units of its securities, with each unit comprised of (i) the Company's 18 month 6% promissory note (collectively, the "April 2005 Notes") and (ii) three year warrants to purchase up to such number of shares of the Company's Common Stock as are determined by the principal amount of the Note purchased by such investor divided by $ 0.85 (collectively the "April 2005 Warrants").

For financial reporting purposes, the Company recorded a discount of $949 to reflect the value of the warrants and is amortizing this amount to the date of maturity.

In September 2006, the Company offered to the holders of the April 2005 Notes to revise certain of the terms of the original offering in order to facilitate an extension to the scheduled maturity date of the Note, (hereinafter the "Amendment"). The Amendment provides that (a) the maturity date of the April 2005 Notes is to be extended by one year from the original maturity date on the original note, (b) the exercise period of the April 2005 Warrants is to be extended from three to five years and the per share exercise price was adjusted to $0.60 and (c) the interest rate on the amounts outstanding under the April 2005 Notes was increased to 8% per annum, effective July 12, 2006. The Amendment also provides that if the Company subsequently issues shares of its Common Stock at an effective per share exercise price less than that of the adjusted per share exercise price of the April 2005 Warrants during the adjusted exercise period, then the exercise price thereof is to be reduced to such lower exercise price; provided, that, this protection will not apply to certain Company equity or debt issuances (i) from approved stock option plans to employees, directors and other service providers, (ii) upon exercise of options and warrants outstanding as of September 27, 2006 and (iii) to Company consultants that an unaffiliated third party would deem to be commercially reasonable and fair.

The Amendment was effective as of September 30, 2006 and the accounting costs related to the Amendment has been fully recognized in 2006. For financial reporting purposes, the Company recorded a one time non-cash finance expense in the amount of $2,534 in respect of the full amount ($1,494) of the April 2005 Note.

In November 2007, holders of $125 of the April 2005 Notes elected to exercise their right represented by the warrants to purchase shares of common stock of the Company. Accordingly the Company issued 244,076 shares of common stock calculated based on principal and accrued interest through the date of exercise. The per share exercise price payable in respect of the April 2005 Warrants being exercised was offset against the amounts owed by the Company under the April 2005 Notes.

As of the date of the financial statements holders of Notes in the principal amount $1,439 have signed the Amendment and the holder of a note in the principal amount of $50 received a repayment of the principle and accrued interest. The holder of a note in the principal amount of $55 has not signed the Amendment. By their terms, all of the notes come due on March 26 2008.

The Company intends to approach these note holders in an effort to reach a resolution whereby the amounts payable under the April 2005 Notes are converted and/or applied to the exercise of the April 2005 Warrants. No assurance can be provided that the Company will be successful in reaching any such resolution.

NOTE 6 - SHORT-TERM LOANS (Cont.)

B. In July 2006, the Company commenced a private placement of units of securities, with each unit comprised of (i) the Company's 8% month promissory note due 12 months from the date of issuance and (ii) warrants as described below. The company raised $550. Under the terms of the offering the principal and accrued interest are due in one balloon payment at the end of the twelve month period. Each purchaser of the note 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 the 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 and to reduce the per share exercise price of the warrants to $0.90. As of the date of the financial statements, 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. The Company repaid to a note holder the principal amount of $75 and the accrued interest thereon. The warrants held by note holders who do not convert are not being re-priced. The Company has not met the scheduled payment on the remaining outstanding $237 owing under these notes and, therefore, under the terms of the notes the Company is in default under these notes. The Company is in discussion with the holders of these notes in an attempt to resolve this matter.

NOTE 7 - LINE OF CREDIT

On March 27, 2007, the Company entered into a Line of Credit Facility with a private investor pursuant to which the Company can borrow up to $200, which can be drawn on demand at the discretion of the Company. The facility continues in effect until January 28, 2008. Amounts outstanding accrue interest at a per annum rate of 9% and accrued interest is payable on a quarterly basis. All amounts borrowed and accrued and unpaid interest are required to be repaid by January 28, 2009. In consideration of the line of credit facility, the Company issued to the investor warrants for 50,000 shares of its Common Stock, exercisable through March 27, 2010 at a per share exercise price of $1.50, of which warrants for 20,000 shares are exercisable immediately and the warrants for the remaining 30,000 shares exercisable only following (and subject to) the Company first draw-down under the facility. The Company did not draw on the credit facility before its expiration and, accordingly, the warrants for the 30,000 shares that were subject to the drawing of the credit facility are no longer exercisable.

NOTE 8 - OTHER CREDITORS

In February 2006 the Company entered into a Distribution Agreement with a Distributor to market and distribute certain of the Company’s products. In accordance with this agreement, as at the balance sheet date, the distributor advanced the Company $485.

NOTE 9 - ACCRUED EXPENSES AND OTHER LIABILITIES

		December 31, 2 0 0 7
Accrued expenses pre merger	$	263
Royalties		317
Other accrued expenses		170
	$	750

NOTE 10 - 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 expenses resulting from the increase in the provision for the years ended December 31, 2007 and 2006 were $115 and $78 respectively.

NOTE 11 - PRIVATE PLACEMENTS

In January 2006, the Company entered into an agreement with an institutional investor for the private placement of 857,143 shares of its Common Stock for net proceeds of $580 net of the payment of the placement related expenses aggregating approximately to $20.

On July 5, 2007, the Company privately placed with an institutional investor 1,444,444 shares of its Common Stock for aggregate gross proceeds of $1,300. The Shares were placed pursuant to a Confidential Private Placement Agreement between the Company and the investor entered into as of July 5, 2007. In connection with the placement of the shares, the Company paid to a placement agent a cash fee of $117.

NOTE 12 - STOCKHOLDER'S EQUITY

A. 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 after 10 years 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 2006 and 2007, relating to options granted through December 31, 2007, the Company applied the provisions of SFAS No. 123(R) and SAB No. 107, which require employee share-based equity awards to be accounted for under the fair value method, SFAS No. 123(R) requires the use of an option pricing model for estimating fair value, which is then amortized to expense over the service periods.

During 2007 and 2006 the Company recorded Stock-based compensation expenses in the amount of $203 and $1,152, respectively.

The following is a summary of the Company’s outstanding options and warrants:

NOTE 12 - STOCKHOLDER'S EQUITY (Cont.)

B. Stock Options:

As of December 31, 2007 an aggregate of 870,000 options remain available for future grants under the Company's 2005 Plan and 2005 Directors Plan.

	December 31, 2007	
	Amount of Options	Weighed Average Exercise Price
Outstanding at the beginning of the year	1,230,000	$ 0.59
Granted	50,000	1.50
Exercised	200,000	0.05
Outstanding at the end of the year	1,080,000	0.73
Exercisable at the end of the year	931,667	0.70

The options outstanding as of December 31, 2007, have exercise prices as follows:

Range of exercise price	Options outstanding as of December 31, 2007	Weighted average remaining contractual life (years)	Weighted average exercise price	Options exercisable as of December 31, 2007	Weighted average exercise price of options exercisable
$ 0.055	100,000	3.32	$ 0.05	100,000	$ 0.05
$ 0.60	720,000	7.63	$ 0.60	645,000	$ 0.60
$ 0.85	110,000	6.14	$ 0.85	70,000	$ 0.85
$ 1.50	50,000	4.47	$ 1.50	50,000	$ 1.50
$ 1.85	100,000	8.81	$ 1.85	66,667	$ 1.85
	1,080,000	7.04	$ 0.73	931,667	$ 0.70

NOTE 12 - STOCKHOLDER'S EQUITY (Cont.)

C. Stock warrants

The Company has the following warrants outstanding:

Issuance date		**number of warrants issued**	**Exercise price**	**Exercisable as of December 31, 2007**	**Exercisable through**
2005	(1)	1,857,066	0.85	-	-
2005	(2)	40,000	0.75	40,000	August 2008
2005	(3)	853,308	0.01	853,308	December 2010-April 2015
February 2006	(2)	60,000	0.85	60,000	January 2009
April 2006	(4)	30,000	0.60	30,000	November 2009
September 2006	(5)	83,333	0.36	83,333	August 2009
September 2006	(5)	57,500	0.60	57,500	September 2010
September 2006	(6)	2,340,491	0.60	2,340,491	September 2010
October 2006	(7)	357,500	updated to 0.9 in Sept 2007	357,500	October 2010
March 2007	(8)	20,000	1.50	20,000	March 2010
September 2007	(4)	40,000	1.50	40,000	September 2011

(1) Warrants issued to investors in the private placement in connection with the April 2005 Notes. According to the Company offer all of these warrants except for 58, 823 were replaced to new warrants see (6) and Note 6a.

(2) Warrants issued to other lenders

(3) Penny warrants issued to service providers and an employee during 2005

(4) Warrants issued to service providers

(5) Warrants issued to consultant for financial services.

(6) Warrants issued according to the Amendment and replace the warrants issued in connection with the April 2005 Notes of which 244,076 were exercised see Note 6a. This number of warrants excludes 428,396 warrants, resulting from accrued interest through the end of the period of the note, which at the holders' election can be converted to warrants.

(7) Issued in connection with a private placement of units of securities see Note 6b.

(8) Issued in connection with line of credit see Note 7

D. Dividends

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

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NOTE 13 - DEFERRED TAXES

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

The results for tax purposes of the Israeli subsidiary are measured in terms of earnings in NIS, after certain adjustments for increases in the Israeli Consumer Price Index ("CPI"). As explained in Note 3c, the functional currency is the U.S. dollar. The difference between the annual change in the Israeli CPI and in the NIS/dollar exchange rate causes a further difference between taxable income and the income before taxes presented in the financial statements. In accordance with paragraph 9(f) of SFAS No. 109, 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 SFAS No. 109, the components of deferred income taxes are as follows:

	December 31, 2 0 0 7
Tax on net operating losses carry forward	$ 1,559
Less - valuation allowance	(1,559)
	-

C. The Company has provided valuation allowances in respect of deferred tax assets resulting from tax loss carry forward 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 carry forward and other temporary differences will not be realized in the foreseeable future.

Net operating loss carry forward as of December 31, 2006 are as follows:

	December 31, 2 0 0 7
Israel	$ 4,263
USA	1,542
Total	$ 5,805

Net operating losses in Israel may be carried forward indefinitely. Net operating losses in the U.S. are available through 2032.

NOTE 14 - COMMITMENTS AND CONTINGENCIES

Lease Commitments

Research and development is carried out at the Company's premises in Kiryat Malachi, Israel, which are comprised of laboratory and development facilities covering an area of 300 square meters. In addition, the Company sub-leases a smaller facility of 112 square meters in Kfar Saba, Israel for local administrative staff. The facilities in Kiryat Malachi, Israel are leased pursuant to a lease agreement that is scheduled to expire in July 2011 at an approximate per month rate of $2.3. The administrative facilities in Israel are leased pursuant to a lease agreement that was originally scheduled to terminate in January 2007 with an option to extend the lease for two additional 12 month periods at an approximate monthly rate of $0.7. The Company exercised the option to extend the lease term.

Government of Israel

The Company's wholly owned subsidiary, SPO Ltd., is committed to pay royalties to the Government of Israel on proceeds from the sale of products, the research and development of which the Government 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, 2007 was $1,086. 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 Government of Israel. The grants were received from the Government 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, 2007 the Company has provided for $330 in royalties payable from such grants.

NOTE 15 - SUBSEQUENT EVENT

On March 11, 2008, the Company issued 75,000 shares of Common Stock to a provider of investment banking services. The service provides is entitled to an additional 75,000 shares of Common Stock upon the occurrence of certain specified events.