

MEDICAL DISCOVERIES INC

Form 10QSB/A

March 28, 2006

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-QSB/A**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the quarterly period ended June 30, 2005**

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 0-12627**

**MEDICAL DISCOVERIES, INC.**

(Exact name of Small Business Issuer as specified in its charter)

Utah

87-0407858

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

1388 S. Foothill Drive, #266, Salt Lake City, Utah 84108

(Address of principal executive offices)

(801) 582-9583

(Issuer's telephone number, including area code)

N/A

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

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

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

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of August 10, 2005, there were 107,829,724 shares of the issuer's Common Stock and 42,000 shares of the issuer's Series A Preferred Stock outstanding.

Transitional Small Business Disclosure Format (check one): Yes  No

**Table of Contents**

**Explanatory Note**

The purpose of this amendment on Form 10-QSB/A to the Quarterly Report on Form 10-QSB of Medical Discoveries, Inc. for the three and six months ended June 30, 2005 is to restate our interim consolidated financial statements for the period ended June 30, 2005 and related disclosures as of and for the period ended June 30, 2005. Generally, no attempt has been made in this Form 10-QSB/A to modify or update other disclosures presented in the original report on Form 10-QSB except as required to reflect the effects of the restatement. The Form 10-QSB/A generally does not reflect events occurring after the filing of the Form 10-QSB or modify or update those disclosures, including the exhibits to the Form 10-QSB, affected by subsequent events. Information not affected by the restatement is unchanged and reflects the disclosures made at the time of the original filing of the Form 10-QSB on August 12, 2005.

Accordingly, this Form 10-QSB/A should be read in conjunction with our filings made with the Securities and Exchange Commission subsequent to the filing of the original Form 10-QSB, including any amendments to those filings. The following items have been amended as a result of the restatement:

Part I - Item 1. Financial Statements

Part I - Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Part II - Item 6. Exhibits

The purpose of the restatement is to give effect to EITF 00-19, Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock, pursuant to which we have reclassified as liabilities our outstanding warrants.

For convenience and ease of reference, we are filing our quarterly report in its entirety with the applicable changes.

---

**TABLE OF CONTENTS**

PART I

FINANCIAL INFORMATION

<u>ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS</u>	3
--	---

<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	11
--	----

<u>ITEM 3. CONTROLS AND PROCEDURES</u>	14
--	----

PART II

OTHER INFORMATION

<u>ITEM 6. EXHIBITS</u>	15
-------------------------	----

<u>SIGNATURES</u>	16
-------------------	----

<u>INDEX TO EXHIBITS</u>	17
--------------------------	----

EXHIBIT 31.1

EXHIBIT 31.2

EXHIBIT 32.1

EXHIBIT 32.2

**Table of Contents**

**PART I  
FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

The following financial statements are filed with this report:

Condensed Consolidated Balance Sheets as of June 30, 2005, (unaudited) and December 31, 2004 (audited)

Condensed Consolidated Statements of Operations for the six-month periods ended June 30, 2005 (unaudited), June 30, 2004 (unaudited), three-month periods ended June 30, 2005 (unaudited), June 30, 2004 (unaudited) and from inception of the development stage on November 20, 1991 through June 30, 2005 (unaudited)

Condensed Consolidated Statements of Cash Flows for the six-month periods ended June 30, 2005 (unaudited), June 30, 2004 (unaudited), and from inception of the development stage on November 20, 1991 through June 30, 2005 (unaudited)

Notes to Unaudited Condensed Consolidated Financial Statements

- 3 -

---

**Table of Contents****MEDICAL DISCOVERIES, INC. AND SUBSIDIARIES**

(A Development Stage Company)  
Condensed Consolidated Balance Sheets  
(Unaudited)

	June 30, 2005 (Restated)	December 31, 2004
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash	\$ 2,424,197	\$ 1,455,397
Deposits	51,100	51,100
<b>Total Current Assets</b>	<b>2,475,297</b>	<b>1,506,497</b>
Property and Equipment, Net	67,621	
<b>TOTAL ASSETS</b>	<b>\$ 2,542,918</b>	<b>\$ 1,506,497</b>
<b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 2,611,343	\$ 2,448,454
Accrued interest payable	222,760	415,262
Notes payable	56,000	336,717
Convertible notes payable	193,200	193,200
Research and development obligation	604,900	
Financial instrument	3,168,872	
<b>Total Current Liabilities</b>	<b>6,857,075</b>	<b>3,393,633</b>
<b>TOTAL LIABILITIES</b>	<b>6,857,075</b>	<b>3,393,633</b>
<b>STOCKHOLDERS DEFICIT</b>		
Preferred stock, Series A, convertible; no par value; 50,000 shares authorized; 42,000 and 12,000 shares issued and outstanding, respectively; (aggregate liquidation preference of \$4,200,000 and \$1,200,000, respectively)	523,334	523,334
	15,246,333	14,918,657

Edgar Filing: MEDICAL DISCOVERIES INC - Form 10QSB/A

Common stock, no par value; 250,000 shares authorized; 107,829,724  
and 105,653,335 shares issued and outstanding, respectively

Additional paid-in capital	988,670	3,424,383
Deficit accumulated prior to the development stage	(1,399,577)	(1,399,577)
Deficit accumulated during the development stage	(19,672,917)	(19,353,933)
Total Stockholders' Deficit	(4,314,157)	(1,887,136)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ 2,542,918	\$ 1,506,497

See notes to condensed consolidated financial statements.

- 4 -

---

**Table of Contents**

**MEDICAL DISCOVERIES, INC. AND SUBSIDIARIES**  
(A Development Stage Company)  
Condensed Consolidated Statements of Operations  
(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,		From Inception of the Development Stage on November 20, 1991 Through June 30, 2005 (Restated)
	2005 (Restated)	2004	2005 (Restated)	2004	
REVENUES	\$	\$	\$	\$	\$ 157,044
COST OF GOODS SOLD					14,564
GROSS PROFIT					142,480
OPERATING EXPENSES					
General and administrative	636,325	369,270	888,321	2,416,963	16,065,291
Research and development	118,520	132,335	1,670,506	170,978	5,219,244
Inventory write-down					96,859
Impairment loss					9,709
License fees					1,001,500
Total Expenses	754,845	501,605	2,558,827	2,587,941	22,392,603
LOSS FROM OPERATIONS	(754,845)	(501,605)	(2,558,827)	(2,587,941)	(22,250,123)
OTHER INCOME (EXPENSES)					
Unrealized gain (loss) on financial instrument	2,133,177		1,990,915		1,990,915
Interest income	9,346	1,426	14,910	3,126	44,481
Interest expense	(7,237)	(33,048)	(23,135)	(86,724)	(1,140,572)
Foreign currency transaction gain	40,900		60,800		60,800
Gain on forgiveness of debt	196,353		196,353		1,431,889
Other income		720		720	881,892



Total Other Income (Expenses)	2,372,539	(30,902)	2,239,843	(82,878)	3,269,405
NET INCOME/(LOSS)	1,617,694	(532,507)	(318,984)	(2,670,819)	(18,980,718)
Preferred stock dividend from beneficial conversion feature					(692,199)
NET INCOME (LOSS) APPLICABLE TO COMMON SHAREHOLDERS	\$ 1,617,694	\$ (532,507)	\$ (318,984)	\$ (2,670,819)	\$ (19,672,917)
BASIC EARNINGS/(LOSS) PER SHARE	\$ 0.02	\$ (0.01)	\$	\$ (0.03)	
DILUTED EARNINGS/(LOSS) PER SHARE	\$ 0.01	\$ (0.01)	\$	\$ (0.03)	

See notes to condensed consolidated financial statements.

- 5 -

**Table of Contents**

**MEDICAL DISCOVERIES, INC. AND SUBSIDIARIES**  
(A Development Stage Company)  
Condensed Consolidated Statements of Cash Flows  
(Unaudited)

	For the Six Months Ended June 30,		From Inception of the Development Stage on November 20, 1991 Through June 30, 2005 (Restated)
	2005 (Restated)	2004	(Restated)
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net loss	\$ (318,984)	\$ (2,670,819)	\$ (18,980,718)
Adjustments to reconcile net loss to net cash used by operating activities:			
Foreign currency transaction gain	(60,800)		(60,800)
Gain on debt restructuring	(196,353)		(1,431,889)
Common stock issued for services, expenses, and litigation	18,750	1,750,954	4,286,467
Commitment for research and development obligation	665,700		665,700
Depreciation	870		101,141
Reduction of escrow receivable from research and development			272,700
Unrealized gain on financial instrument	(1,990,915)		(1,990,915)
Stock options and warrants granted for services			4,811,253
Reduction of legal costs			(130,000)
Write-off of subscriptions receivable			112,500
Impairment loss on assets			9,709
Loss on disposal of equipment			30,364
Write-off of accounts receivable			193,965
Note payable issued for litigation			385,000
Changes in operating assets and liabilities:			
Increase in accounts receivable			(7,529)
Decrease in prepaid expenses		11,331	
Decrease in deferred charges		12,077	
Increase in accounts payable	162,889	293,150	2,455,434
Increase in accrued expenses	23,134	2,516	622,843
 Net Cash Used by Operating Activities	 (1,695,709)	 (600,791)	 (8,654,775)

**CASH FLOWS FROM INVESTING ACTIVITIES**

Edgar Filing: MEDICAL DISCOVERIES INC - Form 10QSB/A

Increase in deposits			(51,100)
Purchase of equipment	(68,491)		(200,675)
Payments received on note receivable			130,000
 Net Cash Used by Investing Activities	 (68,491)		 (121,775)
 <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Issuance of common stock, preferred stock and warrants for cash	3,033,000	718,504	10,060,845
Contributed equity			131,374
Proceeds from notes payable			1,336,613
Payments on notes payable	(300,000)	(195,000)	(801,287)
Proceeds from convertible notes payable			571,702
Payments on convertible notes payable			(98,500)
 Net Cash Provided by Financing Activities	 2,733,000	 523,504	 11,200,747
 NET INCREASE IN CASH	 968,800	 (77,287)	 2,424,197
 CASH AT BEGINNING OF PERIOD	 1,455,397	 424,216	
 CASH AT END OF PERIOD	 \$ 2,424,197	 \$ 346,929	 \$ 2,424,197

See notes to condensed consolidated financial statements.

- 6 -

**Table of Contents**

**MEDICAL DISCOVERIES, INC. AND SUBSIDIARIES**  
(A Development Stage Company)  
Condensed Consolidated Statements of Cash Flows (Continued)  
(Unaudited)

	For the Six Months Ended June 30,	
	2005	2004
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>		
Initial valuation of financial instrument	\$ 6,279,829	\$
Retirement of notes payable with common stock	\$	\$ 175,000
See notes to condensed consolidated financial statements.		

- 7 -

---

**Table of Contents**

**MEDICAL DISCOVERIES, INC. AND SUBSIDIARIES  
(A Development Stage Company)**

**Notes to the Unaudited Condensed Consolidated Financial Statements**

**Note 1 Basis of Presentation**

*Unaudited Interim Consolidated Financial Statements*

The accompanying unaudited consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all adjustments and disclosures necessary for a fair presentation of these financial statements have been included. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's 2004 Annual Report on Form 10-KSB for the year ended December 31, 2004, as filed with the Securities and Exchange Commission. Certain reclassifications and other corrections for rounding have been made in prior-period financial statements to conform to the current-period presentation. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation.

*Loss Per Common share*

Loss per share is computed by dividing net loss applicable to common shareholders by the weighted-average number of shares outstanding. Potential common shares from convertible preferred stock, convertible notes payable, warrants and stock options have not been included as they are anti-dilutive.

*Stock Based Compensation*

The Company accounts for its stock options under Accounting Principles Board (APB) Opinion No. 25 using the intrinsic value method. The Company has elected not to adopt the provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (FAS 123). In accordance with Financial Accounting Standards (SFAS) No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, pro-forma net income, stock-based compensation expense, and earnings per share using the fair value method are stated as follows:

- 8 -

---

**Table of Contents**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Net income (loss) applicable to common shareholders, as reported	\$ 1,617,694	\$(532,507)	\$(318,984)	\$(2,670,819)
Add: Stock-based employee compensation expense included in reported net loss				1,577,000
Deduct: Total stock based employee compensation expense determined under fair value based method for all awards				(1,916,768)
 Pro forma net income (loss) applicable to common shareholders	 \$ 1,617,694	 \$(532,507)	 \$(318,984)	 \$(3,010,587)
 Basic earnings (loss) per share, as reported	 \$ 0.02	 \$ (0.01)	 \$ 0.00	 \$ (0.03)
 Diluted earnings (loss) per share, as reported	 \$ 0.01	 \$ (0.01)	 \$ 0.00	 \$ (0.03)
 Basic earnings (loss) per share, pro forma	 \$ 0.02	 \$ (0.01)	 \$ 0.00	 \$ (0.03)
 Diluted earnings (loss) per share, pro forma	 \$ 0.01	 \$ (0.01)	 \$ 0.00	 \$ (0.03)

Assumptions used to calculate the income statement impact of stock options granted as if the Company had adopted FAS 123 were as follows:

	<b>2005</b>	<b>2004</b>
Expected dividend yield	N/A	
Risk free interest rate	N/A	3.8%
Expected volatility	N/A	220%
Expected life	N/A	7 years
Weighted average fair value per share	N/A	\$0.10
<i>Earnings (Loss) Per Common Share</i>		

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Net income (loss)	\$ 1,617,694	\$(532,507)	\$(318,984)	\$(2,670,819)
Basic weighted-average common shares outstanding	107,580,033	92,393,559	107,043,413	88,478,847

Effect of dilutive securities				
Convertible notes	128,671			
Convertible preferred stock	57,776,847			
Warrants	767,936			
Stock options	16,289,969			
Diluted weighted-average common shares outstanding	182,543,456	92,393,559	107,043,413	88,478,847
Basic net earnings (loss) per common share	\$ 0.02	\$ (0.01)	\$ 0.00	\$ (0.03)
Diluted net earnings (loss) per common share	\$ 0.01	\$ (0.01)	\$ 0.00	\$ (0.03)

Potential common shares from convertible notes payable, convertible preferred stock, warrants and stock options for the three months ended June 30, 2004 and the six months ended June 30, 2005 and 2004 have not been included as their effects are anti dilutive.

## Note 2 Restatement of Financial Statements

The Company's previously issued condensed consolidated financial statements as of June 30, 2005 and for the three and six months ended June 30, 2005 have been restated to record the accounting of the warrants resulting from the issuance of the Series A Convertible Preferred Stock entered into in October 2004 and March 2005 (See Note 4). These warrants, and all other warrants previously issued by the Company, were measured at their fair value and are reflected as a liability on the financial statements. The excess of the fair value of the warrants over the net proceeds received is recognized as an unrealized loss on financial instrument. The reclassification of previously issued warrants to a liability was recognized as a decrease to equity. The Company also remeasured the fair value of the warrants as of June 30, 2005 with the difference being recorded on the income statement as a change in financial instrument. As a result of this restatement, the Company recorded \$3,168,872 of additional current liability related to the fair value of the warrants, with a reduction of \$5,159,787 in equity along with an additional other income of \$1,990,915 recorded as a unrealized gain on financial instrument as of and for the six months ended June 30, 2005.

The following table summarizes the effect of the restatement and reclassification adjustments on the financial statements as of June 30, 2005 and for the three and six months ended June 30, 2005: