

Edgar Filing: INNOVATIVE MEDICAL SERVICES - Form 10QSB/A

INNOVATIVE MEDICAL SERVICES  
Form 10QSB/A  
October 19, 2001

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

FORM 10-QSB/A

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934 For the period ended April 30, 2001  
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TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934 [No Fee Required] For the transition period from \_\_\_ to \_\_\_

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

California  
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(State or other jurisdiction of  
incorporation or organization)

33-0530289  
-----

(IRS Employer Identification No.)

1725 Gillespie Way, El Cajon, California 92020  
-----

(Address of principal executive offices)

619 596 8600  
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Issuer's telephone number

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

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date: 6,785,799 as of June 14, 2001.

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## EXPLANATORY NOTE ON AMENDMENT

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

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

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

### Item 1. Financial Statements

#### CONSOLIDATED BALANCE SHEETS

	(Unaudited)	
	April 30	July 31
	2001	2000
	Restated	Restated
	(Note 6)	(Note 6)
ASSETS		
Current Assets		

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Cash and cash equivalents	\$ 520,086	\$ 1,121,316
Restricted cash	--	204,887
Accounts receivable, net of allowance for doubtful accounts of \$ 225,000 at April 2001 and \$225,000 at July 31, 2000	408,361	411,322
Due from officers and employees	292,913	226,729
Inventories	823,609	796,136
Prepaid expenses	39,805	33,975
	-----	-----
Total current assets	2,084,774	2,794,365
	-----	-----
Property, Plant and Equipment		
Property, plant and equipment	934,132	1,056,252
	-----	-----
Total property, plant and equipment	934,132	1,056,252
	-----	-----
Noncurrent Assets		
Deposits	8,127	14,083
Patents and licenses	956,927	300,910
Deferred acquisition costs	--	202,542
	-----	-----
Total noncurrent assets	965,055	517,535
	-----	-----
Total assets	\$ 3,983,960	\$ 4,368,152
	=====	=====
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	\$ 480,112	\$ 308,812
Accrued liabilities	57,762	36,880
Notes payable	200,000	210,592
	-----	-----
Total current liabilities	737,874	556,284
	-----	-----
Minority interest payable	--	61,697
	-----	-----
Stockholders' Equity		
Class A common stock, no par value: authorized 20,000,000 shares, issued and outstanding 6,630,091 at April 30, 2001 and 5,942,903 at July 31, 2000	11,001,345	10,018,873
Class A warrants: issued and outstanding 3,686,000 warrants	108,750	108,750
Accumulated deficit	(7,864,009)	(6,377,452)
	-----	-----
Total stockholders' equity	3,246,087	3,750,171
	-----	-----
Total liabilities and stockholders' equity	\$ 3,983,960	\$ 4,368,152
	=====	=====

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CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

	For the Nine Months Ended April 30		For the Thr
	2001	2000	2001
Net sales	\$ 1,462,586	\$ 1,574,840	\$ 701,14
Cost of sales	894,457	809,301	469,94
Gross profit	568,129	765,539	231,20
Selling expenses	483,605	406,377	206,43
General and administrative expenses	1,329,340	1,154,143	389,84
Research and development	268,203	84,496	185,40
Total operating costs	2,081,148	1,645,016	781,68
Operating income (loss)	(1,513,019)	(879,477)	(550,48
Other income and (expense):			
Interest income	25,932	4,218	2,77
Interest Expense	(11,100)	(65,286)	(1,45
Total other income (expense)	14,832	(61,068)	1,31
Income (loss) before income taxes, minority Interest in subsidiary operations and change in accounting principle	(1,498,187)	(940,545)	(549,16
Federal and state income taxes	1,200	600	80
Income (loss) before minority interest in subsidiary operations and change in accounting principle	(1,499,387)	(941,145)	(549,96
Minority interest in subsidiary operations	14,972	26,718	-
Net income (loss) before cumulative change in accounting principle	(1,484,415)	(914,427)	(549,96
Cumulative effect of change in accounting principle	--	79,896	-
Net income (loss)	\$ (1,484,415)	\$ (834,531)	\$ (549,96

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Net income (loss) per common share before change in accounting principle (basic)	\$ (0.24)	\$ (0.17)	\$ (0.0)
Cumulative effect of change in accounting principle	--	0.02	--
Net income (loss) per common share (basic)	\$ (0.24)	\$ (0.15)	\$ (0.0)
Net income (loss) per common share before change in accounting principal (diluted)	\$ (0.24)	\$ (0.16)	\$ (0.0)
Cumulative effect of change in accounting principle	--	0.01	--
Net income (loss) per common share (diluted)	\$ (0.24)	\$ (0.15)	\$ (0.0)

	Nine Months Ended April 30 2001	Year Ended July 31 2000
CONSOLIDATED STATEMENTS OF ACCUMULATED DEFICITS		
Balance, beginning of period	\$ (6,377,452)	\$ (3,840,610)
Net income (loss)	(1,484,415)	(1,745,431)
Balance, end of period	\$ (7,864,009)	\$ (5,586,041)

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	For the Nine Months April 30	
	2001	2000
Cash flows from operating activities		
Net income (loss)	\$ (1,484,415)	\$ (83,000)
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization	63,579	
Depreciation	143,602	11,000
Minority interest in subsidiary operations	(61,697)	7,000
Changes in assets and liabilities:		
(Increase) decrease in restricted cash	204,887	
(Increase) decrease in accounts receivable	2,961	(22,000)
(Increase) decrease in due from officers and employees	(66,183)	12,000
(Increase) decrease in prepaid expense	(5,830)	
(Increase) decrease in inventory	(27,473)	(2,000)

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(Increase) decrease in deposits	5,956	(
(Increase) decrease in goodwill	--	
(Increase) decrease in intangible assets	--	(4
Increase (decrease) in accounts payable	171,300	(27
Increase (decrease) in accrued liabilities	20,882	1
	-----	-----
Net cash provided (used) by operating activities	(1,032,431)	(1,06
	-----	-----
Cash flows from investing activities		
Purchase of property, plant and equipment	(87,202)	(31
Purchase of patent and licenses	(453,475)	(15
	-----	-----
Net cash (used) in investing activities	(540,677)	(46
	-----	-----
Cash flows from financing activities		
Proceeds from debt obligations	200,000	12
Payments on debt obligations	(210,593)	(30
Proceeds from sale of common stock	982,471	3,10
	-----	-----
Net cash provided by financing activities	971,878	2,92
	-----	-----
Net increase (decrease) in cash and cash equivalents	(601,230)	1,39
Cash at beginning of period	1,121,316	2
	-----	-----
Cash at end of period	\$ 520,086	\$ 1,41
	=====	=====
Supplemental disclosures of cash flow information		
Cash paid for interest paid	\$ 11,100	\$ 6
Cash paid for taxes paid	\$ 1,200	\$
Noncash investing and financing activities:		
Value of shares issued in exchange for Nutripure.com minority interest	\$ 550,011	\$
Value of shares issued in exchange for ETI H2O	\$ 140,953	\$

NOTES TO FINANCIAL STATEMENTS

Note 1. Financial Statements

The financial statements included herein have been prepared by Innovative Medical Services (the Company) without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted as allowed by such rules and regulations, and Innovative Medical Services believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the July 31, 2000 audited financial statements and the accompanying notes thereto. While management believes the procedures followed in preparing these financial statements are reasonable, the accuracy of the amounts are in some

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respects dependent upon the facts that will exist and procedures that will be accomplished by Innovative Medical Services later in the year. The results of operations for the interim periods are not necessarily indicative of the results of operations for the full year.

### Note 2. Stock Dividend and Share Exchange

In December 1999, Innovative Medical Services formed a wholly owned subsidiary, Nutripure.com, to capitalize on internet commerce opportunities focusing on health and wellness. Total authorized capitalization of the corporation was 50,000,000 shares of common stock at \$.001 par value. IMS purchased 8,000,000 shares and the newly formed board of directors of the subsidiary purchased 900,000 shares all at par value. In February of 2000 the corporation raised \$550,000 in a private placement of 1,100,000 at \$0.50 per share. At this point the minority interest represented 20% of the outstanding common stock of the corporation. Minority interest payable and income from operations were first recognized in the consolidated financial statements in the quarter ended 4/30/2000. On October 24, 2000, the Company issued 183,337 shares of common stock valued at \$550,011 (\$3.00 per share) in exchange of 1,100,000 shares of Nutripure.com stock representing the 10% minority interest outstanding shares of Nutripure.com, which were originally purchased for \$.50 cents per share. Management of Nutripure.com did not exchange shares. Shares held by Management were eliminated by a reverse split, effective March 16, 2001.

In January 2000, Innovative Medical Services declared a dividend in kind of Nutripure.com common stock as the Company began the process to spin off Nutripure.com as a separate public company. The record date and distribution date were to be set following completion of the registration of Nutripure.com as a reporting issuer with the Securities and Exchange Commission. Following the announcement of the dividend, however, adverse market conditions for solely internet-based ventures eroded Management's confidence in the viability of a public market for Nutripure.com common stock. Therefore, the Board amended its declaration of a Nutripure.com dividend to a dividend of Innovative Medical Services' common stock and the Company purchased the minority interest in Nutripure.com through an exchange of shares. The Company retains Nutripure.com as an operating division of Innovative Medical Services in order to minimize the substantial administrative expense associated with launching and operating a public company.

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

### Note 3. Acquisitions

In November 2000, Innovative Medical Services acquired 100% of the stock of ETIH2O, Inc., a Florida corporation, for 56,381 shares of IMS stock valued at \$140,953 (\$2.50 per share). The transaction was recorded using the purchase method of accounting. The assets acquired and liabilities assumed are as follows:

Assets:

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Notes Receivable	\$ 33,655
Inventories	32,077
Equipment	16,932
Licensing & Distribution Rights	118,324
	-----
Total Assets	200,988
Liabilities:	
Notes Payable - IMS	60,035
	-----
Equity	\$ 140,953
	=====

Assets and liabilities were valued at historical cost and no goodwill was recorded in the transaction. Results of operations of ETIH2O Inc. are included in the current quarter. The acquired entity was a startup company, if results of operations were included in prior periods and shown as though the companies had been combined at the beginning of the period, it would not have a material affect on the consolidated financial statements of Innovative Medical Services.

The Company merged ETIH2O with a newly formed Nevada corporation of similar name and dissolved the Florida corporation. ETI-H2O, a privately held technology corporation, developed Axenohl is responsible for processing, and production of Axenohl and Axen. ETI-H2O is also responsible for all supervision of all research, studies, data and quality control of the Axenohl/Axen product line.

In April 2001, the Company completed the purchase of the entire right, title and interest in and to specific patent-pending boric acid pesticide technologies and all rights, title and interest in and to all patents for RoachX from a private individual, for approximately \$160,000 in cash. The owner/inventor accepted a position with the Company to serve as Senior Scientist and to head the Company's new Pest Management Division. The employment agreement included bonuses at certain revenue thresholds of RoachX sales. The owner/inventor of RoachX died unexpectedly in June of 2001. Because the initial payment was primarily for the patents and for the EPA licenses it is included in Patents and Licenses and will be amortized over a period of 17 years. RoachX is a safe pesticide technology containing a familiar active ingredient, boric acid, bound to a masking agent and combined with an attractant fragrance and proteins in a colloidal suspension. The patent-pending time-released formulation protects the boric acid from dissolving in water and maintains the integrity of the pesticide to obtain maximum killing effect.

#### Note 4. Common Stock

In addition to the common stock issued, described in Notes 2 and 3, the Company completed the following private placements during the nine months ended April 30, 2001:

1. A \$250,000 private placement in October 2000 in which the Company issued 94,340 shares of common stock to six investors at \$2.65 per Unit.
2. A \$250,002 private placement in January 2001 in which the Company issued 83,334 shares of common stock to six investors at \$3.00 per Unit. Each Unit contained one share of common stock and a warrant to acquire an additional share of common stock for \$4.00 per share up to January 28, 2003.
3. A \$225,000 private placement in April 2001 in which the



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Company issued 150,000 shares of common stock to four investors at \$1.50 per Unit. As part of this registration the Company also issued \$200,000 of convertible debentures at 10% interest due July 31, 2001. The holders of this debenture are entitled to convert all or any amount over \$10,000 of principal face amount and accrued interest into Units each consisting of one share of Common Stock and a Common Stock Purchase Warrant. The conversion price for each Unit shall equal 80% of the average closing bid price for the five trading days immediately preceding the receipt of Notice of Conversion. The exercise price for the Warrant in each unit shall equal 120% of the average closing bid price for the five trading days immediately preceding the receipt of Notice of Conversion.

The Company also received approximately \$151,000 from the exercise of options during the nine-month period ending April 30, 2001.

### Note 5. Segment Information

In accordance with the provisions of SFAS No. 131, certain information is disclosed based on the way management organizes financial information for making operating decisions and assessing performance. In determining operating segments, the Company reviewed the current management structure reporting to the chief operating decision-maker ('CODM') and analyzed the reporting the CODM receives to allocate resources and measure performance.

The Company's business activities are divided, managed and conducted in two basic business segments, the Water Treatment segment and the Bio Sciences segment. These two segments were determined by management based upon the inherent differences in the end use of the products, the inherent differences in the value added processes made by the Company, the differences in the regulatory requirements and the inherent differences in the strategies required to successfully market finished products. The Water Treatment segment can be broken down further into Commercial Water treatment, Residential Retail products and the Nutripure Water Dealer program. Bio Sciences include two new products, Axenohl (Silver Ion Technology) and RoachX (Pest Management).

The Company plans to utilize multiple forms of analysis and control to evaluate the performance of the segments and to evaluate investment decisions. In general, gross margin and Earnings Before Interest Depreciation and Amortization (EBITDA) are deemed to be the most significant measurements of performance, although collection volumes and certain controllable costs also provide useful "early warning signs" of future performance. Because the Company has just recently changed to multiple segments, historical data on gross profit and income from operations is not available. However, the following is a summary of segment revenues at April 30, 2001:

	Three months Ended April 30, 2001	Nine months Ended April 30, 2001
Revenues:		
Commercial Water Treatment	\$415,600	\$1,142,800
Residential Retail Products	111,500	145,800

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Nutripure Dealership Program	140,200	140,200
Silver Ion Technology	30,300	30,300
Pest Management	3,500	3,500
Total Revenues	\$701,100	\$1,462,600

Significant customers consisted primarily of domestic retail chain pharmacies. Sales concentrations to major chain stores were approximately \$329,800 and \$754,600, respectively, for the three months and the nine months ended April 30, 2001. No customer accounted for more than 10% of consolidated sales. Export sales were \$48,000 for the quarter and \$89,300 for the nine months ended April 30, 2001.

### Note 6. Write Down of Impaired Assets

Ampromed was purchased in October of 1998 to enable the Company to take advantage of the lucrative markets for medical and dental supplies in Brazil and other South American countries and to later introduce and distribute its water purification products to these markets. Since the acquisition the economic conditions in the region have declined and implementation of the project has been delayed. The Company no longer has immediate plans to import medical and dental supplies into Brazil but believes, however, that Ampromed is a vital part of its plan to market and sell "Axenohl", RoachX and the Nutripure line of water treatment products. The Company believes there is considerable value in owning a Brazilian Limitada but the Company has reassessed the value of the goodwill the customer list it purchased Statement of Financial Accounting Standards No. 121 (Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of) requires an entity to review long-lived assets and identifiable intangible assets when, among other factors, there is a change in the extent or manner in which an asset is to be used or when there is a significant change in the business climate that could affect the value of an asset. Because the Company suspended its plans to market medical and dental supplies in Brazil in May of 2000 the Company believes the Goodwill and Customer List should be written off, and the value of the Limitada license to do business in Brazil should be written down to what it would cost to acquire in today's market. This is estimated to be approximately \$150,000 which will be amortized over its expected useful life of 15 years. The total reduction of assets from this restatement was \$505,400. Because the effect of the write-down on the statements of operations presented was only a \$2,100 they have not been restated. Instead the adjustment will be made in the fourth quarter of 2001.

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

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

### OVERVIEW

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

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

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

During the first nine months of fiscal 2001, Innovative Medical Services created and launched the Nutripure water dealer program, a comprehensive sales and marketing program for the water treatment industry. The program offers existing independent water treatment dealers a line of residential water softening and other point-of-use water treatment equipment for sale to the public under IMS' Nutripure brand. In addition, the program provides complementary, industry-unique financing that extends credit to consumers for the purchase of water treatment equipment. The Company has partnered with MBNA and Automated Payment Services ("APS") to strengthen and streamline the financing program and administration of the Nutripure dealer program. Under the unique Nutripure program, independent water treatment dealers may now offer credit to all prospective customers because the Nutripure programs offers competitive, risk-based interest rates. In addition, through APS, dealers can obtain real-time processing and approval information online for their customers. The dealer base for the program grows steadily, and the Company expects revenues from the Nutripure dealer program to accelerate in the second half of the year.

In the third quarter, the Company announced that it has partnered with USFilter(R) to provide equipment to the Nutripure dealers. The Company believes that combining the unique Nutripure marketing and financing programs with USFilter's excellent products positions it to become a leader in the home water treatment industry. Also in the third quarter, Innovative Medical Services launched its first Nutripure Master Dealer.

Innovative Medical Services launched its second Nutripure Master Dealer on June 6, 2001. The June launch, like the May launch, included a 2-day training seminar for the sales people. The conversion to Nutripure included adopting the Nutripure logo and style on all buildings, collateral materials, vehicles and attire. Innovative Medical Services expects to add four additional master dealers in the coming quarter. The Company has been receiving purchase orders and shipping products to its master dealers since April and is on schedule to add four additional master dealers in the coming quarter.

Innovative Medical Services has obtained worldwide manufacturing and marketing rights for advanced silver ion technologies. Axenohl(TM)/Axen(TM) is an antimicrobial technology that uses the biocidal properties of ionic silver to kill bacteria, viruses and fungi. Axenohl's broad effectiveness works to prevent and treat infection, and, unlike traditional disinfectants, Axenohl is non-toxic and environmentally friendly. Potential applications for products containing Axenohl include municipal and point-of-use/point-of-entry water treatment, food processing, personal disinfecting retail products, and commercial and retail hard surface disinfecting products. In addition, this technology may provide

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applications in the healthcare market for treatment of disease, including human and animal infections and wounds, and for disinfecting applications in hospitals, clinics, surgical centers, dental offices and other medical and health related facilities.

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

In March 2001, the US Patent and Trademark Office issued US Patent Number 6,197,814 for Axenohl. Patent applications have been filed in more than 50 countries and regions, and the World Intellectual Property Organization published the Axenohl International Patent Application on April 22, 1999 under publication number WO 99/18790. The inventor of Axenohl is Mr. Andrew B. Arata, President of ETIH2O Corporation, and the registered patent assignee is NVID International, Inc. Innovative Medical Services entered into a sales, marketing, distribution and manufacturing agreement for particular geographic areas and particular market segments for Axenohl/Axen with NVID International on November 24, 1999. On March 26, 2000, Innovative Medical Services entered into a superseding contract with NVID and ETI-H2O, Inc. of Florida for exclusive, worldwide sales, marketing and distribution rights for Axenohl/Axen. The latter contract is the subject of pending litigation with NVID. The lawsuit seeks a judicial declaration that the Manufacturing, Licensing and Distribution Agreement, dated March 26, 2000 between the Company, NVID, International, Inc. and ETI-H2O does not constitute a binding contract and seeks unspecified damages. The lawsuit does not challenge the binding effect of the Standard Manufacturing Agreements dated November 30, 1998 and September 17, 1999 between NVID, International, Inc. and ETI-H2O and the November 24, 1999 License Agreement between the Company and NVID, International, Inc. The dispute does not affect any of the Company's rights associated with the EPA registrations. Under the registrations, ETI-H2O is the only EPA-approved producer of Axenohl and Axen. Registration under the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA) is required before a product can be sold in the United States. Should NVID prevail in its lawsuit, Innovative Medical Services would be limited by both geography and market segments in its exclusive rights to sell Axenohl.

The EPA registrations for Axen and Axenohl as hard surface disinfectants were granted in June of 2001. Axen(TM) is also approved in Costa Rica for use as a water treatment chemical, hard surface disinfectant, and industrial disinfectant for direct food contact. (Axen(TM) is the trade name for the use dilution Axenohl solution.) Approval in Costa Rica for human and veterinary topical use is expected by the end of the year.

In the third quarter, Dodo & Company began purchasing product in preparation for the September launch of its new product line of acne-fighting cosmetics containing Axen as its active ingredient. The Company expects to continue to receive purchase orders from Dodo & Company. In May 2001, Innovative Medical Services began realizing revenues from sales of Axenohl to additional international customers.

During the quarter, the Company completed the acquisition of a new pesticide technology. The EPA-approved RoachX(R) was the first product to launch from the line, and the Company has submitted for and anticipates EPA approval for AntX. RoachX is over 96% effective in three to four days with one application for indoor and outdoor eradication of cockroaches, and can be used near children and food preparation areas. Boric acid is a well-known and effective deterrent of cockroaches and will kill them on contact, but cockroaches do not naturally eat the repellent. Although many pesticide products contain boric acid as the listed

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active ingredient, the Company believes RoachX to be new because of the combination of boric acid and glycerin in a colloidal suspension to create three unique results: 1) The formula protects the boric acid from water and humidity, 2) The cockroaches perceive formulation as food and will actually eat the glycerin-encapsulated boric acid, and 3) The formula acts as a time-released pesticide, allowing the cockroach to return to the nest before it dies and then becomes a "bait station" for other roaches in the colony. The product line, containing particular formulas for specific pests, provides excellent results against cockroaches, ants, palmetto bugs, silverfish, waterbugs, ticks, fleas, lice and garden pests. RoachX is available through Vopak (formerly Van, Waters & Rogers) and members of the Speckoz group of nine regional independent wholesalers.

Innovative Medical Services believes that with RoachX, and AntX it is well positioned to capitalize on the recent federal restrictions on poisonous pesticides and the subsequent industry trend of eliminating spray pesticides and increasing the use of bait-style products like RoachX and AntX. Of all pesticides not rated "non-toxic", boric acid, the active ingredient in RoachX, has been found to be "least toxic" technology by the U.S. Environmental Protection Agency and is 96-100% effective, as tested by the USDA. Many states, including California, New York and Florida, have legislated to eliminate pesticide spraying in public schools and move to 100% IPM (integrated pest management) practices, such as using baits. In addition to school districts, RoachX is currently being tested and test marketed by dozens of companies in the US and abroad and is also being tested by the US Navy aboard ships afloat as a safer and more effective alternative to traditional sprays and other baits that evaporate or emit fumes.

Also during the quarter, Innovative Medical Services announced the re-launch of its corporate website - [www.IMSPURE.com](http://www.IMSPURE.com)(TM), and the launch of two new product websites - [www.Axenohl.com](http://www.Axenohl.com)(TM) and [www.RoachX.com](http://www.RoachX.com)(TM). The dynamic, user-friendly websites link to each other and provide a complete overview of the company, its subsidiaries, products, executive management team, company news and stock information. The new websites also provide key technical data to Innovative Medical Services' current and prospective customers. Visitors to the sites may also go to [www.Nutripure.com](http://www.Nutripure.com)(R), the Innovative Medical Services e-commerce health products subsidiary. Nutripure.com provides consumers a wide variety of Bergen Brunswig vitamins, minerals, nutritional supplements, homeopathic remedies and natural products. In addition to merchandise, the supersite offers comprehensive health and wellness information in an easy-to-access, intuitive reference format.

### RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED APRIL 30, 2001 VERSUS THREE MONTHS ENDED APRIL 30, 2000

During the quarter, the Company began to realize revenues from multiple product lines in its different divisions. In order to be more informative regarding distribution of revenues, discussion of revenues will be in terms of the Company's water treatment, silver ionization and pesticide divisions, rather than in terms of individual products. Total revenues of \$701,100 in the third quarter ended April 30, 2001 were 96% higher than the \$357,800 in revenues reported for the same quarter ended April 30, 2000. Water treatment division sales in the 2001 quarter were \$667,300. The increase was due to increased Fillmaster system sales, and increased residential water treatment sales, including \$140,200 in revenues from the new Nutripure water dealer program. Revenues from the silver ionization division in the quarter were \$30,300. Revenues from the pesticide division were \$3,500.

Currently, water dealer program sales consist mostly of sales of other manufacturers' products to independent dealers. Revenue is recognized on sales to dealers as shipped since the Company currently does not sell to third party customers of the dealers. Revenues of silver ion and pesticide products are

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recognized on shipment where the sale is made f.o.b. shipping point.

Gross profit in the most recent quarter was \$231,200 versus \$123,600 in the year-earlier quarter. The gross profit of 33% in 2001 remained relatively constant compared to the 35% gross profit in 2000. The slight decrease in gross profit reflects the changing product mix of the Company. Although the gross profit of products in the Nutripure line of water treatment products is slightly less than the gross profit of the specialized Fillmaster line of pharmacy products, the margins associated with RoachX and Axen/Axenohl are higher than those of the water treatment products.

Net loss for the quarter ended April 30, 2001 was \$550,000 versus a loss of \$649,200 for the same quarter in 2000. During the period General and Administrative expenses decreased 35% from \$582,900 to \$389,900. This decrease was mainly due to a reduction in administrative salaries and bad debt expense. Also General and Administrative expenses in the recent quarter were reduced \$50,200 by an adjustment to inventory which allocates a portion of G & A expense to "Work in Process". Research and Development costs increased 359% from \$40,400 to \$185,400. The increase was due to costs associated with research and testing of the Axen and Axenohl products and costs associated with RoachX. Selling and marketing expenses also increased over the prior period rising 40% from \$148,000 to \$206,400. The increase was due to expenses associated with the launch of the Nutripure dealer program as well as the costs associated with the marketing of the Company's newest product, RoachX.

In addition to the ongoing expansion of the water dealer program, distribution of the Company's other products in the Water Treatment Division continues to grow. Fillmaster rollouts to Shaws and Kaiser Permanente are on schedule. Wal-Mart submits reorders on a regular basis for the Nutripure 2000 countertop water filtration systems stocked in over 350 of its highest volume stores, and the Company is now connected directly to Wal-Mart's ordering and inventory system via EDI (Electronic Data Interchange). CVS continues to purchase Fillmaster systems for its new and remodeled stores at a rate of at least 50 units per month and plans to continue the roll out through the end of the calendar year. Fillmaster and replacement filter sales to the Company's existing customers continues steadily. Nutripure Sport Bottle, Nutripure 2000 and Fillmaster are being tested in Canada, with initial placement in some Pharma Plus and Wal-Mart Canada Stores. Drug Trading, the eight largest wholesaler in North America, is now purchasing Fillmaster, Nutripure 2000 and Nutripure Sport Bottles for their member and associate stores, and Fillmaster, Nutripure 2000 and Nutripure Sport bottles are being sold through several other regional chains in the US and Canada. In addition to retail sales, the Company is conducting a successful direct mail program with Nutripure 2000 and the Nutripure Sport Bottle.

During the quarter, the Company launched its first Nutripure Master Dealer, and, subsequently, launched its second Master Dealer in June. Revenues from the program began in the third quarter, and continue to ramp up, with over \$61,800 in sales since April 30, 2001, the end of the third quarter, and a backlog of orders for approximately \$48,000.

In March 2001, Innovative Medical Services signed a five-year contract with Dodo & Company, a leading Korean cosmetics manufacturer and marketer to provide Axenohl. Dodo & Company will purchase approximately \$1.2 million dollars of product from Innovative Medical Services over five years. In addition to the purchase price, Innovative Medical Services will receive a royalty on sales of the Axen-containing products. The Company anticipates that, over the five years, the revenues from Dodo & Company cosmetics royalties will exceed \$5 Million. In the third quarter, Dodo & Company began purchasing product in April 2001 in preparation for the September launch of its new product line.

In May 2001, Innovative Medical Services began realizing revenues from sales of

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Axenohl to additional international customers. Revenues from Axenohl began in the second half of the third quarter, and continue to ramp up, with over \$230,000 in sales since April 30, 2001, the end of the third quarter. In addition to sales to Dodo cosmetics, the recent sales of Axenohl have been to companies in South Korea for testing purposes. Regulatory clearances have not yet been issued in South Korea.

In January 2001, the Company announced its acquisition of a new, non-toxic pesticide technology. The acquisition was completed in April 2001 for approximately \$160,000. RoachX is the first product to launch, and during the third quarter, the Company focused on gaining distribution to more than 40,000 commercial pest control companies through national wholesalers. The commercial industry provides larger dollar volume potential and select and controlled distribution. During the third quarter, the Company began receiving purchase orders and shipping RoachX to customers in the western regions of the United States. The national kickoff will take place at the National Pest Management Association meeting in New Orleans in October. Innovative Medical Services has taken an aggressive approach by introducing an incentive point program for wholesalers to accumulate points used to redeem top brand merchandise based upon purchases.

Revenues from RoachX began in the second half of the third quarter, and continue to ramp up, with over \$23,000 in sales since the end of the third quarter. The Company expects revenues from sales of RoachX to accelerate in the coming quarter and have a very significant short and long-term impact on revenues and earnings.

### RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED APRIL 30, 2001 VERSUS NINE MONTHS ENDED APRIL 30, 2000

Revenues of \$1,462,600 in the nine months ended April 30, 2001 were 7% lower than the \$1,574,800 in revenues reported for the nine months ended April 30, 2000. The decrease was due to a decline in sales of Fillmaster pharmaceutical purification systems and filter replacements in the current nine-month period. Management believes the decline in Fillmaster revenues was due to multiple factors, including the fact that the market for pharmacy products is maturing in that there is a decreasing number of pharmacy chains that do not have water filtration products, and that the Company has sold systems to most major chains. The focus for further Fillmaster sales will be on incremental and upgrade sales to individual pharmacies within current chain accounts, although the Company is still actively pursuing Fillmaster sales to remaining chains. Management expects to close such volume sales to new chains in the coming year, and, as in prior years, those sales will result in spikes in Fillmaster revenues because of the nature of a bulk sale of a rollout to a new customer as compared to the continued, slower rollout of systems to new and remodeled stores of existing customers. The Company works to retain customers with its Customer Service Plan 2000, a multi-year service and warranty contract. Fillmaster customers that subscribe to the Company's Customer Service Plan have contracted to continue purchasing; otherwise, customers do not have an obligation to continue historic purchasing patterns.

Water treatment division sales in the 2001 period were \$1,428,800. Revenues from the silver ionization division in the period were \$30,300. Revenues from the pesticide division were \$3,500.

Gross profits for the nine months ended April 30, 2001 were \$568,100 versus \$765,500 in 2000. The gross profit of 39% in 2001 was lower versus the 49% gross profit in 2000. The decrease in gross profit percentage was due to fixed production and labor costs being applied to the lower sales volume for the period and to additional costs associated with the launch of the Company's new product lines.

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Net loss for first nine months ended April 30, 2001 was \$1,484,400 versus \$834,500 for the same period last year. The decreased income was due to decreased sales and to an increase in Research and Development costs and General and Administrative expenses as the Company positions for anticipated rapid growth activity related to new ventures, including expanded distribution of the Nutripure line of water systems, RoachX, and the new silver ion technologies. Research and Development costs increased \$183,700 (217%) from \$84,500 in the prior period to \$268,200 in the current period. Selling and marketing expenses rose \$77,200 (19%) from \$406,400 to \$483,600. General and Administrative expenses increased \$121,000 (9%) from \$1,219,400 in fiscal 2000 to \$1,340,400 in fiscal 2001. \$178,200 of these expenses were related to Nutripure.com, a wholly owned subsidiary. The Company believes it has created and maintains a robust website at a fraction of the cost of other stand alone e-commerce engines. Although sales to date from Nutripure.com are non-material, the Company has minimized costs related to the operation and promotion of Nutripure.com and has plans for strategic partnership and future promotion. The Company does not anticipate significant revenues from Nutripure.com until the coming fiscal year.

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

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

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

### LIQUIDITY AND CAPITAL RESOURCES

During the nine months ended April 30, 2001, the Company's current assets to liabilities ratio decreased from 5.02 to 2.83. Current assets decreased \$709,300 from \$2,794,400 to \$2,084,800. The change in current assets during the nine months ended April 30, 2001 include a decrease of \$601,200 in cash on hand and a decrease of \$204,900 in restricted cash which was pledged against a line of credit that was paid off during the period. Accounts and notes receivable, inventories and prepaid expenses increased slightly during the recent nine months. Current liabilities rose \$181,600 which was mainly a result of an increase in accounts payable. Notes payable decreased \$210,600 as the Company paid off its line of credit but increased \$200,000 by the sale of convertible



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debentures described below.

The Company's liquidity is unaffected by the financing program offered to participating dealers in the Nutripure water dealer program. The Company receives funds from its primary lender and disperses the funds to the dealer, less a commission charged by the Company, upon completion of the contract. The primary lender disperses funds to the Company. The Company records a liability when the funds are received and relief of liability when funds are dispersed, and the Company does not retain liability on the credit extended.

Cash flows used from operations were \$1,032,400 in the first nine months of fiscal year 2001. Cash flows used from operations were \$1,064,500 for the same period in 2000. For those periods, cash flows used in investing activities included, respectively, \$87,200 and \$316,900 for the purchase of fixed assets and \$453,500 and \$150,500 for the purchase of patents and licenses. Cash flows from financing activities were \$971,800 during the current period which included the following common stock transactions:

1. A \$250,000 private placement in October 2000 in which the Company issued 94,340 shares of common stock to six investors at \$2.65 per Unit.
2. A \$250,002 private placement in January 2001 in which the Company issued 83,334 shares of common stock to six investors at \$3.00 per Unit. Each Unit contained one share of common stock and a warrant to acquire an additional share of common stock for \$4.00 per share up to January 28, 2003.
3. A \$225,000 private placement in April 2001 in which the Company issued 150,000 shares of common stock to four investors at \$1.50 per Unit. As part of this registration the Company also issued \$200,000 of convertible debentures at 10% interest due July 31, 2001. The holders of this debenture are entitled to convert all or any amount over \$10,000 of principal face amount and accrued interest into Units each consisting of one share of Common Stock and a Common Stock Purchase Warrant. The conversion price for each Unit shall equal 80% of the average closing bid price for the five trading days immediately preceding the receipt of Notice of Conversion.
4. In November 2000, Innovative Medical Services acquired 100% of the stock of ETIH20, Inc., a Florida corporation, for approximately 56,400 shares of IMS stock valued at approximately \$141,000. The transaction was recorded using the purchase method of accounting. 5. In addition, approximately \$151,000 was received from exercise of outstanding stock options.

In the prior nine month period, cash flows from financing activities were \$2,923,000 which included \$2,596,500 received through private placements of IMS and Nutripure.com. The total decrease in cash and cash equivalents for the 2001 period was \$601,200 as compared to an increase of \$1,391,200 during the same period in 2000.

### PART 2 OTHER INFORMATION

#### ITEM 1

##### LEGAL PROCEEDINGS

There have been no developments in the case involving the Company and Zedburn Corporation et al in Circuit Court of Pinellas County, Florida as previously discussed. Rulings on motions are on appeal, and as of June 14, 2001, no rulings have been received.

The Company has filed an action against John Woodard, former Vice President of Sales, in Superior Court in the State of California in April 2000. The Company has alleged Mr. Woodard violated his non-competition/non-disclosure agreement. The Company is seeking monetary damages and injunctive relief.

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The Company has also filed an action against Fresh Water Systems, Inc., Steven Norvell, Brian Folk and Eric Norvell in Superior Court in the State of California. The action was filed in August 2000. The Company alleges Fresh Water Systems and its officers and directors misappropriated trade secrets of the Company obtained from former employees of the Company, engaged in unfair competition in violation of the California Unfair Practices Act, tortious interference with contractual relations, tortious interference with prospective business advantage, fraud, trade libel and conspiracy. The Company is seeking monetary damages and injunctive relief.

The Company filed an action against Eckerd Corporation in Superior Court in the State of California in August 2000. The Company alleges Eckerd Corporation has not paid for Fillmaster products ordered by and shipped to Eckerd pharmacies. The Company seeks monetary damages not less than \$170,000 plus interest and attorney's fees. In September 2000, the action was removed to the Federal Court for the Southern District of California. On March 5, 2001 Defendant's motion to "Dismiss for Lack of Personal Jurisdiction" was granted.. The Company filed an appeal on April 5, 2001. This matter is now before the United States Court of Appeals for the Ninth Circuit.

On April 12, 2001, NVID, International, Inc. filed a declaratory judgment action in the Circuit Court of Pinellas County, Florida against the Company and ETI-H2O, Inc. The lawsuit seeks a judicial declaration that the Manufacturing, Licensing and Distribution Agreement, dated March 26, 2000 between the Company, NVID, International, Inc. and ETI-H2O does not constitute a binding contract and seeks unspecified damages. The lawsuit does not challenge the binding effect of the Standard Manufacturing Agreements dated November 30, 1998 and September 17, 1999 between NVID, International, Inc. and ETI-H2O and the November 24, 1999 License Agreement between the Company and NVID, International, Inc.

On May 17, 2001, the Company and ETI-H2O removed NVID'S declaratory judgment action from Pinellas County Circuit Court to the United States District Court for the Middle District of Florida. The Company and ETI-H2O has filed a Motion To Dismiss, which is currently pending.

On May 7, 2001, the Company and EIT-H2O filed a separate action, a Petition to Compel Arbitration, in the United States District Court for the Southern District of California based on arbitration clauses contained in the March 26, 2000 and November 24, 1999 agreements. Contemporaneously with filing the Petition, the Company and ETI-H2O filed a demand for arbitration against NVID, International, Inc. with the American Arbitration Association ("AAA") in San Diego, California. NVID, International, Inc. has notified AAA that it objects to the arbitration demand. The Company's Petition to compel Arbitration is scheduled to be heard in July 2001.

### ITEM 2.

#### CHANGES IN SECURITIES

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

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

In April 2001, the Company issued 150,000 shares of common stock in a private placement to four investors at \$1.50 per Unit. In April, the Company also issued \$200,000 of convertible debentures at 10% interest due July 31, 2001. The holders of this debenture are entitled to convert all or any amount over \$10,000

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of principal face amount and accrued interest into Units, each consisting of one share of Common Stock and a Common Stock Purchase Warrant. The conversion price for each Unit shall equal 80% of the average closing bid price for the five trading days immediately preceding the receipt of Notice of Conversion. The exercise price of the Warrants shall equal 120% of the average closing bid price for the five trading days immediately preceding the receipt of Notice of Conversion.

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

ITEM 3.  
DEFAULTS UPON SENIOR SECURITIES  
Not applicable.

ITEM 4.  
SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS  
Not applicable.

ITEM 5.  
OTHER INFORMATION  
Not applicable.

ITEM 6.  
EXHIBITS AND REPORTS ON FORM 8-K

- (A) EXHIBITS
  - 10.5 -- Dodo Agreement dated March 5, 2001  
[CONFIDENTIAL TREATMENT REQUESTED FOR CERTAIN OMITTED INFORMATION FILED SEPARATLEY]
  - 10.8 -- Nutripure Dealer Agreement
  - 10.9 -- Sales Finance Agreements
- EXHIBITS DESCRIPTION
  - 11 Statement re: computation of per share earnings

- (B) REPORTS ON FORM 8-K
  - The Company filed a Report on Form 8-K on May 24, 2001 regarding the current IMS/ETI-H2O Manufacturing, Licensing and Distribution Agreement with NVID. The entire contract was filed as an exhibit.

SIGNATURES

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

INNOVATIVE MEDICAL SERVICES  
(Registrant)

By: /s/ Michael L. Krall  
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Michael L. Krall, President/CEO  
October 8, 2001

By: /s/ Gary Brownell  
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Gary Brownell, Chief Financial Officer  
October 8, 2001