INNOVATIVE MEDICAL SERVICES
Form 10QSB/A
August 07, 2003

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

FORM 10-QSB/A

(Mark One)
[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the period ended April 30, 2002

[ ] 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

INNOVATIVE MEDICAL SERVICES
(Name of small business issuer in its charter)

California	33-0530289
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

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

619 596 8600
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: 7,939,899 as of June 14, 2002.

Explanatory note on amendment

The Registrant has filled this amendment to reflect changes made to its financial statements for the fiscal year ended July 31, 2002 with respect to the

writing off of certain start up costs which had been previously capitalized. The Amendment revises and replaces the following sections:

Item 1. Financial Statements and Notes to Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations;

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

CONSOLIDATED BALANCE SHEETS

	(Unaudited) April 30 2002 Restated (Note 2)	July 31 2001 Restated (Note 2)
ASSETS		
Current Assets		
Cash and cash equivalents	$ 209,774	$ 207,092
Accounts receivable, net of allowance for doubtful accounts of $ 125,000 at April 30, 2002 and $115,000 at July 31, 2001	597,102	570,733
Due from officers and employees	245,284	240,001
Inventories	588,261	711,018
Prepaid expenses	186,518	182,556
Total current assets	1,826,939	1,911,400
Property, Plant and Equipment		
Property, plant and equipment	717,789	903,072
Total property, plant and equipment	717,789	903,072
Noncurrent Assets		
Deposits	8,953	8,127

Patents and license	2,654,507	1,014,282
Total noncurrent assets	2,663,460	1,022,409
Total assets	$ 5,208,188	$ 3,836,881
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$ 722,409	$ 543,992
Accrued liabilities	194,452	96,691
Notes payable	519,338	-
Total current liabilities	1,436,199	640,683
Stockholders' Equity		
Class A common stock, no par value: authorized 50,000,000 shares, issued and outstanding 7,939,899 at April 30, 2002 and 6,954,699 at July 31, 2001	13,607,991	11,619,665
Accumulated deficit	(9,836,002)	(8,423,467)
Total stockholders' equity	3,771,989	3,196,198
Total liabilities and stockholders' equity	$ 5,208,188	$ 3,836,881

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

	For the Nine Months Ended April 30		For the Three Month April 30	
	2002 Restated (Note 2)	2001	2002 Restated (Note 2)	20
Net sales	$ 2,575,624	$ 1,462,586	$ 877,441	$ 7
Cost of sales	1,304,151	894,457	498,332	4
Gross profit	1,271,473	568,129	379,109	2
Selling expenses	576,641	483,605	222,115	2

General and administrative expenses	1,505,976	1,329,341	481,006	3
Research and development	571,201	268,203	254,989	1
Total operating costs	2,653,818	2,081,149	958,110	7
Operating income (loss)	(1,382,345)	(1,513,020)	(579,001)	(5
Other income and (expense):				
Interest income	467	25,932	124	
Interest Expense	(28,857)	(11,100)	(17,667)	
Total other income (expense)	(28,390)	14,832	(17,543)	
Income (loss) before income taxes, minority Interest in subsidiary operations	(1,410,735)	(1,498,188)	(596,544)	(5
Federal and state income taxes	1,800	1,200	600	
Income (loss) before minority interest in subsidiary operations	(1,412,535)	(1,499,388)	(597,144)	(5
Minority interest in subsidiary operations	-	14,972	-	
Net income (loss)	$ (1,412,535)	$ (1,484,416)	$ (597,144)	$ (5
Net income (loss) per common share (basic)	$ (0.19)	$ (0.24)	$ (0.08)	$
Net income (loss) per common share (diluted)	$ (0.19)	$ (0.24)	$ (0.08)	$

CONSOLIDATED STATEMENTS OF ACCUMULATED DEFICITS	Nine Months Ended April 30 2002	Year Jul 20
Balance, beginning of period	$ (8,423,467)	$ (6,4
Net income (loss)	(1,412,535)	(2,0
Balance, end of period	$ (9,836,002)	$ (8,4

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	For the Nine Months Ended April 30	
	2002 Restated (Note 2)	2001
Cash flows from operating activities		
Net income (loss)	$ (1,412,535)	$ (1,484,415)
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization	144,206	63,579
Depreciation	200,895	143,602
Minority interest in subsidiary operations	-	(61,697)
Changes in assets and liabilities:		
(Increase) decrease in restricted cash	-	204,887
(Increase) decrease in accounts receivable	(26,368)	2,961
(Increase) decrease in due from officers and employees	(5,283)	(66,183)
(Increase) decrease in prepaid expense	(3,962)	(5,830)
(Increase) decrease in inventory	122,757	(27,473)
(Increase) decrease in deposits	(826)	5,956
(Increase) decrease in goodwill	-	-
(Increase) decrease in intangible assets	-	-
Increase (decrease) in accounts payable	178,414	171,300
Increase (decrease) in accrued liabilities	97,764	20,882
Net cash provided (used) by operating activities	(704,938)	(1,032,431)
Cash flows from investing activities		
Purchase of patents and licenses	(87,196)	(453,475)
Purchase of property, plant and equipment	(159,818)	(87,202)
Net cash (used) in investing activities	(247,014)	(540,677)
Cash flows from financing activities		
Proceeds from debt obligations	519,338	200,000
Payments on debt obligations	-	(210,593)
Proceeds from sale of common stock	435,296	982,471
Net cash provided by financing activities	954,634	971,878
Net increase (decrease) in cash and cash equivalents	2,682	(601,230)
Cash at beginning of period	207,092	1,121,316

Cash at end of period	$ 209,774	$ 520,086
Supplemental disclosures of cash flow information		
Cash paid for interest paid	$ 28,857	$ 11,100
Cash paid for taxes paid	$ 1,800	$ 1,200
Noncash investing and financing activities:		
Value of shares issued in exchange for Silver Ion Technology paten	$ 1,540,600	$ -
Value of shares issued in exchange for Nutripure,com minority interest		$ 550,011
Value of shares issued in exchange 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, 2001 audited financial statements and the accompanying notes thereto. While management believes the procedures followed in preparing these financial statements are reasonable, the accuracy of the amounts are in some respects dependent upon the facts that will exist and procedures that will be accomplished by Innovative Medical Services later in the year. The results of operations for the interim periods are not necessarily indicative of the results of operations for the full year.

Note 2. Restatement of Financial Statements - Start-up Costs and Warranty Liability

The accompanying financial statements have been restated to correct an error in the recording and reporting of Start-up Costs and the Warranty Liability of the Company.

The Company expended $230,000 during the year ended July 31, 2001 and an additional $47,831 during the July 31, 2002 fiscal year in an effort to acquire and setup a Korean corporation. The Company capitalized these costs as Deferred Acquisition costs as incurred. The Company later determined the venture was not feasible and decided not to go forward with the project. The total costs of $277,831 were written-off as Abandoned Projects at July 31, 2002. We now believe the treatment of these costs was not correct. The accompanying financial statements now show these costs as expensed when incurred as Start-up Costs. The income statement effect of this restatement was to increase the net loss at July 31, 2001 by $230,000 and to decrease the net loss at July 31, 2002 by $230,000 and to increase net loss for the nine months ended April 30, 2002 by $13,000. The balance sheet effect is to show a decrease in Deferred Acquisition Costs of $230,000 at July 31, 2001 and a decrease of $243,000 at April 30, 2002.

In previous years the Company had not recorded a liability for its future warranty obligation. Because the Company has now computed and booked this liability the accompanying financial statements have been restated to include this obligation. A liability of $39,459 at April 30, 2002 and $33,791 at July 31, 2001 are now included in Accrued Liabilities. The income statement effect of these items was to reduce net loss at July 31, 2001 by $729, increase the net loss for the three months ended April 30, 2002 by $492 and to increase net loss for the six months ended April 30, 2002 by $5,669.

Note 3. 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 Biosciences 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 includes Commercial Water treatment, Residential Retail products and the Nutripure Water Dealer program. Bioscience includes two product lines: 1) Axenohl products (Silver Ion Technology) and 2) Pest Management products including RoachX, AntX, TrapX and Pro's Choice.

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 Taxes 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, current and historical data on gross profit, income from operations and changes in material assets is not yet available. However, the following is a summary of segment revenues at April 30, 2001 and April 30, 2002:

	Three months Ended April 30, 2001	% Total Sales	Three months Ended April 30, 2002	% Total Sales
Revenues:				
Water Treatment	$ 598,400	95%	$ 574,500	66%
Bioscience	34,600	5%	302,000	34%
Total Revenues	$ 633,000	100%	$ 876,500	100%

	Nine months Ended April 30, 2001	% Total Sales	Nine months Ended April 30, 2002	% Total Sales
Revenues:				
Water Treatment	$ 1,358,200	98%	$ 1,534,300	60%
Bioscience	34,300	2%	1,038,600	40%
Total Revenues	$ 1,392,500	100%	$ 2,572,900	100%

Note 4. Patent Acquisition

On November 30, 2001, we settled the dispute with NVID. Under the terms of the agreement, NVID dismissed its case against us and assigned the Axenohl patent to us. In return, NVID received 651,000 shares of our common stock and 5% of our gross Axenohl sales until March 2018, the end of the life of the patent. Innovative Medical Services issued an additional 49,000 shares to settle claims on behalf of NVID. There are minimum royalties of $1,000,000 for the period of November 2001 to July 31, 2004 and for each fiscal year thereafter. If the minimum royalty for any period is not met, we have the right, in our sole and absolute discretion to pay NVID the deficiency in cash, in our common stock at prevailing market prices or transfer the patent back to NVID without further royalty obligation. Royalty expense under the terms of this agreement of $6,600 was accrued during the current quarter. As the sole owner of the patent, we control the granting of rights to market and distribute Axenohl and related products. ETI-H2O, our wholly owned subsidiary, retains sole manufacturing rights. As part of the settlement agreement, we have entered into non-exclusive marketing agreements for Axenohl with Watertronics, Ltd., for the United Kingdom and Aqua Biotech S.A. de C.V. for the Republic of Mexico. In addition, Innovative Medical Services reaffirmed the exclusive right of Sistecam, S.A. to manufacture and market Axenohl for sale in Costa Rica for the duration of the patent.

Note 5. Stock Option Plans

On March 11, 2002, the Company's shareholders approved the Innovative Medical Services 2002 Employee Incentive Stock Option Plan. The purpose of the Plan is to advance the business and development of the Company and its shareholders by affording to the key employees and non-employee directors of the Company the opportunity to acquire a propriety interest in the Company by the grant of Options to acquire shares of the Company's common stock.

The Options granted are "Incentive Stock Options" within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, for certain key employees. The Plan is administered by an

Administrative Committee whom shall serve a one-year term. Subject to anti-dilution provisions, the Plan may issue Options to acquire up to 4,000,000 shares to Key Employees. The exercise price for Options shall be set by the Administrative Committee but shall not be for less than the fair market value of the shares on the date the Option is granted. The period in which Options can be exercised shall be set by the Administrative Committee not to exceed five years from the date of Grant. The Plan may be terminated, modified or amended by the Board of directors upon the recommendation of the Administrative Committee.

On March 11, 2002, the Company's shareholders approved the Innovative Medical Services 2002- Non-Qualified Stock Option Plan. The purpose of the Plan is to advance the business and development of the Company and its shareholders by affording Eligible Plan Participants the opportunity to acquire a propriety interest in the Company by the grant of Options to acquire shares of the Company's common stock. Eligible Plan Participants include the Directors and Officers of the Company, consultants, advisors and other individuals deemed by the Compensation Committee to provide valuable services to the Company but who are not otherwise eligible to participate in the Employee Incentive Stock Option Plan.

The Plan is administered by an Administrative Committee whom shall serve a one-year term. The Administrative Committee is composed of the Board's Compensation/Administration Committee. Subject to anti-dilution provisions, the Plan may issue Options to acquire up to 2,000,000 shares to Eligible Plan Participants. The Company will not receive any consideration for the grant of options under the Plan and approximate market value of the shares to be reserved for the plan is $4,000,000 based upon the average thirty trading day closing price for the Company's common stock for the period ending January 31, 2002. The exercise price for Options shall be set by the Administrative Committee but shall not be for less than the fair market value of the shares on the date the Option is granted. Fair market value shall mean the average of the closing price for ten consecutive trading days at which the Stock is listed in the Nasdaq quotation system ending on the day prior to the date an Option is granted. The period in which Options can be exercised shall be set by the Administrative Committee not to exceed five years from the date of Grant. To date no options have been granted from these new plans.

Note 6. Line of Credit

The Company has obtained line of credit financing with a private lender. The term of the agreement is one year beginning September 15, 2001 with an interest rate of 12% per annum The Company may borrow up to $500,000, which is fully secured against the Company's accounts receivable. At April 30, 2002, the Company had drawn $500,000 against the line of credit.

Note 7. Common Stock

During the quarter ended April 30, 2002, the Board of Directors and the stockholders approved an amendment to Article Four of the

Company's Articles of Incorporation to increase the number of shares of common stock which the Company is authorized to issue from 20,000,000 to 50,000,000. The number of shares outstanding increased 11,800 during the quarter from the exercise of stock options.

Note 8. Reclassifications

Certain reclassifications have been made to previously reported statements to conform to the Company's current financial statement format.

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 Innovative Medical Services.

OVERVIEW

Innovative Medical Services began as a provider of pharmaceutical water purification products. Although the majority of our current revenues are still from the pharmacy industry, we have expanded from our commercial pharmacy market into other, broader markets with new products, including residential water filtration systems and bioscience technologies.

Water Treatment Division

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 Scanmaster(TM) bar code reader. We also market proprietary National Sanitation Foundation certified replacement filters for the Fillmaster Systems.

Our Nutripure(R) line of water treatment and filtration systems includes Nutripure whole-house water softening systems, the Nutripure reverse osmosis point-of-use systems, the Nutripure 2000 countertop water filtration system and the Nutripure Sport filtered sport bottle. We distribute our various Nutripure products in several ways, including retail sales, catalogue placement, business-to-business sales and in-home sales presentations.

Bioscience Division

Our bioscience division includes a silver ion technology called Axenohl(TM). Axenohl is a patented, aqueous disinfectant. The use dilution formulation of Axenohl is called Axen(TM). The EPA registration for use of Axenohl and Axen as hard surface disinfectants has been issued. The first Axen-containing product we developed was our CleanKill(TM) hard surface disinfectant for sale to the pest control industry. We intend not only to sell our own Axen-based hard surface disinfectant products, but also to sell Axen as an additive to other manufacturer's products.

The current EPA approval of Axen is based on prior testing using 12-part per million (ppm) strength. In February and March 2002, we announced the results of a battery of tests using an increased formula strength of 30-ppm to meet

rigorous standards of potential product partners and to achieve the shortest possible kill times on a greater scope of microbes. The tests were performed by nationally recognized independent laboratories under AOAC protocol and GLP regulations in accordance with EPA regulations.

Specific Axen test results include:

- 30-Second Kill Time ---At 30 ppm, Axen demonstrated a 30-second, 99.9999% kill of standard indicator organisms including Staphylococcus aureus ATCC 6538, Pseudomonas aeruginosa ATCC 15442 and Salmonella cholerasuis ATCC 10708. Each is regarded as ever present in nearly every person's life and is also a frequent human pathogen.

- Residual Kill Activity --- The residual activity of Axen was tested at 0, 1, 6, and 24 hours after application to a hard surface against standard indicator organisms (Staphylococcus aureus ATCC 6538, Pseudomonas aeruginosa ATCC 15442 and Salmonella cholerasuis ATCC 10708). Quantitative residual results at 24 hours after initial application show a 99.99% reduction in all three bacteria tested.

- Bacteria---Additional testing of Axen against Methicillin Resistant Staphylococcus aureus ATCC 700698 (MRSA), Vancomycin Resistant Enterococcus faecium ATCC 700221 (VRE) and Escherichia coli OH157 ATCC 43888 demonstrated a 99.9999% kill in 2 minutes. These specific bacteria are especially problematic in hospitals because of their resistance to antibiotics. Further, Axen showed a 99.9999% kill in 30 seconds against Listeria monocytogenes ATCC 19111. Food processing operations are challenged to keep this bacterium under control.

- Fungus --- Axen demonstrated a 99.9999% kill in 10 minutes of the common athlete's foot fungus, Trichophyton mentagrophytes ATCC 9533. After review and approval by the EPA, this data will allow the Company to add a fungicidal claim to its hard surface disinfectant label.

- Viruses --- Axen also demonstrated 99.9999% virucidal efficacy against HIV Type 1 in 30 seconds, Herpes simplex virus type 1 in one minute, and Influenza A virus ATCC VR-544, Rhinovirus type R 37 ATCC VR-1147, Strain 151-1 and Poliovirus type 2 ATCC VR-1022, Strain Lansing in 10 minutes. After review and approval by the EPA, this data will allow the Company to add these virucidal claims to its hard surface disinfectant label.

We have begun the submission process of this new test data to the EPA as the basis for expanding the existing Axen efficacy claims as a hard surface disinfectant.

Based on the EPA toxicity categorization of antimicrobial products that ranges from Category I (high toxicity) down to Category IV, Axen, with its combination of the biocidal properties of ionic silver and citric acid, is an EPA Category IV antimicrobial for which precautionary labeling statements are normally not required. This compares with Category II warning statements for most leading brands of antimicrobial products.

We plan to pursue additional EPA and FDA regulatory approvals for other applications. Additional possible uses for this product include wound care, topical infection care and personal disinfecting retail products, which may require FDA approvals, as well as municipal water treatment and point-of-use/point-of-entry water treatment products, which may require additional EPA approvals. The investment necessary to pursue regulatory approval for Axenohl will be significant, but as additional US and international approvals for Axenohl uses are received, we expect revenues to develop quickly.

We currently operate under a five-year contract signed in March 2001 to provide Axenohl to Dodo & Company, a Korean cosmetics manufacturer and marketer. Dodo & Company has developed an Axen-containing line of skin care products for the treatment of acne. The product line, called A-Clinic, launched in South Korea in September 2001. Under the contract, Dodo & Company will purchase approximately $1.2 million dollars of product from us over five years. In addition to the purchase price, we receive a royalty on sales of the Axen-containing products. We anticipate that, over the five years, the revenues from Dodo & Company cosmetics royalties will exceed $5 Million. Regulatory clearances have not been issued in South Korea.

Originally, we obtained worldwide manufacturing and marketing rights to Axen/Axenohl from NVID International, Inc., in a License Agreement dated November 24, 1999 and a Manufacturing, Licensing and Distribution Agreement dated March 26, 2000 which supersedes the November 1999 Agreement. The latter agreement became the subject of litigation that has subsequently settled in November 2001.

Under the terms of the settlement, we acquired the Axenohl patent from NVID in exchange for 700,000 shares of our common stock and 5% of our gross Axenohl sales until March 2018, the end of the life of the patent. There are minimum royalties of $1,000,000 for the period of November 2001 to July 31, 2004 and for each fiscal year thereafter. If the minimum royalty for any period is not met, we have the right, in our sole and absolute discretion to pay NVID the deficiency in cash, in our common stock at prevailing market prices or transfer the patent back to NVID without further royalty obligation. As the sole owner of the patent, we control the granting of rights to market and distribute Axenohl and related products. ETI-H2O, our wholly owned subsidiary, retains sole manufacturing rights. As part of the settlement agreement, we have entered into non-exclusive marketing agreements for Axenohl with Watertronics, Ltd., for the United Kingdom and Aqua Biotech S.A. de C.V. for the Republic of Mexico. In addition, Innovative Medical Services reaffirmed the exclusive right of Sistecam, S.A. to manufacture and market Axenohl for sale in Costa Rica for the duration of the patent.

The United States patent for Axenohl was issued on March 6, 2001, and a supplemental patent has been filed to cover the substitution of 14 other organic acids for citric acid in the formulation.

Our bioscience division also includes a line of pesticide technologies. The EPA-approved, patent-pending RoachX(TM) was the first product to launch from the line. The national kickoff took place at the National Pest Management Association meeting in New Orleans, Louisiana, in October 2001. We are selling RoachX through Vopak (formerly Van, Waters & Rogers) and members of the Speckoz group of nine regional independent wholesalers.

United States Department of Agriculture testing confirms that 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 active ingredient, we believe RoachX to be new because of the combination of boric acid, glycerin and a protein-based attractant in a colloidal suspension to create three unique results: 1) The formula protects the boric acid from water and humidity, 2) The cockroaches perceive the 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. We believe the product line, containing particular formulas for specific pests, is effective against cockroaches, ants, palmetto bugs, silverfish, waterbugs, ticks, fleas, lice and garden pests.

At the October trade show, we also launched Pro's Choice(TM) caulk for pest control operators. We repackage an NSF, USDA and FDA approved food-grade silicone caulk as our Pro's Choice product. Pro's Choice does not contain any pesticide and is a convenience tool for pest control operators for "exclusion", or the filling of cracks and crevices to create a physical barrier insects cannot penetrate.

In January 2002, we formally launched CleanKill(TM), the Axen-based hard surface disinfectant for the pest control industry. CleanKill is approved by the EPA as an additional brand name of Axen. We believe adding sales of these products to the already climbing RoachX revenues will have a very material positive effect on revenues in the coming fiscal year.

In March 2002, we received EPA approval for our second pesticide product, AntX(TM). Targeted to pest control professionals, AntX 75 is available through commercial distributors in the pesticide industry. AntX 75 combines our patent-pending glycerol boric acid technology with a carbohydrate-based attractant to create a non-drying, time-released bait. The non-drying formula allows ants to feed until the bait is gone. The formula also completely masks the borate in the bait and produces a time-released effect that lengthens the kill time, giving the ants time to return to their nests before dying.

In April 2002, we launched two formulas of non-toxic TrapX rodent lure. This conveniently packaged, non-drying EPA-exempt product is available in fruit formula for roof rats and protein formula for Norway rats and squirrels. Both formulas work well for field and house mice and may be used in all types of traps. TrapX is available through commercial distributors in the pesticide industry.

Although we think that the pesticide technologies will have the most immediate material impact on revenues in the coming quarters, we believe that the silver ion technologies will ultimately become the largest revenue generator for Innovative Medical Services. We intend not only to sell our own Axen-based products, like CleanKill, but also to sell Axen as an additive to other manufacturer's products, like Dodo Cosmetics' acne-fighting product line. We believe that the innumerable applications for a Class IV, tasteless, odorless, highly effective antimicrobial agent present an outstanding market opportunity for our Axenohl products.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED APRIL 30, 2002 VERSUS THREE MONTHS ENDED APRIL 30, 2001 During the quarter, we continued to realize revenues from multiple product lines in our different divisions. In order to be more informative regarding distribution of revenues, discussion of revenues will be in terms of our water treatment and bioscience divisions.

Revenues of $877,400 in the quarter ended April 30, 2002 were 25% higher than the $701,100 in revenues reported for the quarter ended April 30, 2001. In the prior period, revenues were mostly from sales of commercial and residential water treatment products. In the current period, increased revenues were generated from our new bioscience division. During the quarter, water treatment division revenues of $574,500 were 4% lower than the $598,400 in the prior quarter and include $419,500 in Fillmaster commercial water purification product sales and $154,900 in Nutripure residential water treatment product sales. This compares to $ 398,500 in Fillmaster and $199,900 in Nutripure sales in the quarter ended April 30, 2001. The 4% difference reflects an unusually large order shipped for Nutripure 2000 countertop systems last year. Bioscience

division revenues in the current quarter of $302,000 were 773% higher than the prior quarter and include silver ionization product sales of $202,500 and pesticide product sales of $99,500. In the quarter ended April 30, 2001, revenues from silver ionization product sales were $30,000 and pesticide product sales were $4,600.

Revenues of all products are recognized on shipment where the sale is made F.O.B. shipping point, including the Nutripure water dealer program sales, which consist mostly of sales of other manufacturers' products to independent dealers. Revenue is recognized on sales to dealers as shipped since we currently do not sell to third party customers of the dealers.

Gross profit for the quarter ended April 30, 2002 was $379,100 versus $231,200 in 2001. Gross profit percentage of 43% in 2002 was higher versus 33% in 2001. The increase in gross profit percentage was largely due to higher margins associated with the silver ionization and pesticide products.

Net loss for the quarter ended April 30, 2002 was $597,100 versus net loss of $550,000 for the same period in 2001. During the quarter, General and Administrative expenses increased 23% or $91,200 from $389,800 in fiscal 2001 to $481,000 in fiscal 2002. Administrative expenses increased due to increased amortization associated with patents and licenses as well as to increased costs associated with the hiring of additional employees. Selling expense increased approximately $15,700, or 8%, from $206,400 in 2001 to $222,100 in 2002 because of increased costs associated with development of marketing materials, hiring of additional sales personnel, trade shows and product launches for the bioscience division. Research and Development costs were higher; increasing $69,600 or 38% from $185,400 in the quarter ended April 30, 2001 to $255,000 in the current quarter. The increase was due mainly to costs associated with development of bioscience division products.

RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED APRIL 30, 2002 VERSUS NINE MONTHS ENDED APRIL 30, 2001 Revenues of $2,575,600 in the nine months ended April 30, 2002 were 76% higher than the $1,462,600 in revenues reported for the nine months ended April 30, 2001. In the prior period, revenues were mostly from sales of commercial and residential water treatment products. In the current period, revenues were also generated from our new bioscience division. The increase in revenues was due to both an increase in revenues in our water treatment division and the addition of revenues from our bioscience division. During the current nine months, water treatment division revenues of $1,534,300 were 13% higher than the prior nine-month period and include $1,179,400 in Fillmaster commercial water purification product sales and $354,900 in Nutripure residential water treatment product sales. Bioscience division revenues were $1,038,600 and include silver ionization product sales of $719,200 and pesticide product sales of $289,400. This compares to a total of $34,600 in sales of the bioscience division for the quarter ended April 30, 2001.

Gross profit for the nine months ended April 30, 2002 was $1,271,500 versus $568,100 in 2001. Gross profit percentage of 49% in 2002 was higher versus 39% in 2001. The increase in gross profit percentage was largely due to higher margins associated with the silver ionization and pesticide products.

Net loss for the nine months ended April 30, 2002 was $1,412,500 versus net loss of $1,484,400 for the same period in 2001. Selling expense increased approximately $93,000, 19%, from $483,600 in 2001 to $576,600 in 2002 because of increased costs associated with development of marketing materials, hiring of additional sales personnel, trade shows and product launches for the bioscience division. Research and Development costs were higher; increasing $303,000 or 113% from $268,200 in nine months ended April 30, 2001 to $571,200 in the current period. The increase was due mainly to costs associated with development of bioscience division products.

During the current nine months, General and Administrative expenses increased 13% or $176,600 from $1,329,400 in fiscal 2001 to $1,506,000 in fiscal 2002. Included in General and Administrative expenses during the current nine month period is $134,400 of expenses related to Nutripure.com, a wholly owned subsidiary incorporated in the state of Nevada in December 1999. Nutripure.com was an e-commerce website that provided consumers a wide variety of vitamins, minerals, nutritional supplements, homeopathic remedies and natural products. In December 2001, Bergen Brunswig Corporation requested we release it from its contract to provide the vitamins, minerals, nutritional supplements, homeopathic remedies and natural products sold on our Nutripure.com website. We agreed, and therefore, on January 15, 2002, Bergen Brunswig Corporation terminated the distribution license for these products. As a result, we have closed our e-commerce division. Sales to date from the e-commerce division have not been material and closing the e-commerce division will result in cost savings of approximately $35,000 per quarter in maintenance and service fees, amortization and labor costs. The General and Administrative expenses of Nutripure.com in the nine months ended April 30, 2002 included writing off approximately $70,000 of the value attributed to the Bergen Brunswig Corporation license. The website software with a value of approximately $75,000 is being held as an asset for resale.

LIQUIDITY AND CAPITAL RESOURCES

From inception through April 30, 2002, we have financed our operations primarily through our initial public offering in August of 1996, by subsequent private placement stock sales. We have operated without long-term debt and have no plans to obtain long-term financing in the next twelve months. We believe that sales from our new product lines will not provide sufficient capital resources to sustain operations and fund product development through fiscal year 2002. In the short term, we expect to raise capital through equity sales as necessary to fund future growth until we operate above the break-even point. We continually evaluate opportunities to sell additional equity or debt securities, or obtain credit facilities from lenders to strengthen our financial position. The sale of additional equity or convertible debt securities could result in additional dilution to our stockholders, but is necessary to execute our growth plan.

Our liquidity is unaffected by the financing program offered to participating dealers in the Nutripure water dealer program. We receive funds from our primary lender and disperse the funds to the dealer, less a commission charged by us, upon completion of the contract. The primary lender disperses funds to us. We record a liability when the funds are received and relief of liability when funds are dispersed, and we do not retain liability on the credit extended.

During the fiscal nine months ended April 30, 2002, our current assets to liabilities ratio decreased from 3.15 to 1.31. Current assets decreased $84,500 from $1,911,400 at July 31, 2001 to $1,826,900 at April 30, 2002 due mainly to a decrease in inventories. Current liabilities increased $789,800 from $606,900 to $1,396,700. The increase in current liabilities was mainly the result of an increase in notes payable of $500,000 and an increase in accounts payable of $178,400. The note payable was drawn against a $500,000 credit line we established during the period, which is secured against our accounts receivable.

Noncurrent assets increased by $1,654,100 during the period due to the increase in Patents and Licenses of approximately $1,640,000 mainly from the purchase of a Silver Ionization technology patent. Of this amount, $87,200 was paid in cash and $1,540,600 was paid with common stock of the Company.

Cash flows used from operations were $705,000 in the nine months ended April 30, 2002 and $1,032,400 in 2001. For fiscal 2002, cash flows used in investing activities included $144,900 for the purchase of machinery and equipment and $87,200 for the purchase of patents and licenses. In fiscal 2001 cash flows used

in investing activities included $87,200 for the purchase of machinery and equipment and $453,500 for the purchase of patents and licenses.

Cash flows from financing activities were $954,600 in fiscal 2002 and $971,900 in fiscal 2001. Financing activities for the current period included the addition of $500,000 in notes payable from a line of credit established in September 2001. Cash flows from financing activities also included an increase of common stock of $435,300 which included a $400,000 private placement in which the Company issued 250,000 shares of common stock to eleven accredited investors at a price of $1.60 per share. The Company also received approximately $68,000 from the exercise of options during the period. In the prior period, cash flows from financing activities included an increase of common stock of $982,500 from the sale of common stock, which included a $250,000 private placement in January 2001 and the acquisition of 100% of the stock of ETIH2O, Inc., a Florida corporation, for approximately 56,400 shares of IMS stock valued at approximately $141,000. In addition, approximately $132,700 was received from exercise of outstanding stock options in the prior period. The total increase in cash and cash equivalents for 2002 was $2,700 as compared to a decrease of $601,200 during the same period in 2001.

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

Michael L. Krall, President/CEO
August 4, 2003

By: /s/ Gary Brownell

Gary Brownell, Chief Financial Officer
August 4, 2003