MEDICAL DISCOVERIES INC
Form 10QSB
August 14, 2002

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-QSB

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2002

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
For the transition period from ___________ to ___________

Commission file number 0-12627

MEDICAL DISCOVERIES, INC.

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

Utah	87-0407858
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

738 Aspenwood Lane, Twin Falls, Idaho 83301

(Address of principal executive offices)
(208) 736-1799

(Issuer s telephone number, including area code)
N/A

(Former name, former address and former fiscal year, if changed since last report)
Check whether the issuer: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS:

State the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date: As of July 24, 2002, there were 36,030,119 shares of the issuer s Common Stock outstanding.

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

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PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The following financial statements are filed with this report:

Condensed Consolidated Balance Sheet as of June 30, 2002, (unaudited) and December 31, 2001

Condensed Consolidated Statements of Operations for the three- and six-month periods ended June 30, 2002 (unaudited) and June 30, 2001 (unaudited) and cumulative amounts since inception through June 30, 2002 (unaudited)

Condensed Consolidated Statements of Cash Flows for the six-month periods ended June 30, 2002 (unaudited) and June 30, 2001 (unaudited) and cumulative amounts since inception through June 30, 2002 (unaudited)

Notes to Unaudited Financial Statements

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MEDICAL DISCOVERIES, INC. AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
CONDENSED CONSOLIDATED BALANCE SHEET
As of June 30, 2002 (Unaudited) and December 31, 2001

	June 30, 2002	December 31, 2001
Current assets		
Cash	$ 871	$ 2,481
Current portion of deferred charges	48,304	48,305
Total current assets	49,175	50,786
Equipment, at cost, net of accumulated depreciation		679
Deferred charges, less current portion	36,229	60,381
Total assets	$ 85,404	$ 111,846
Current liabilities		
Accounts payable	$ 2,176,114	$ 1,832,340
Accrued interest	280,197	279,860
Current portion of notes payable	394,217	477,717
Convertible notes payable	948,201	743,200
Total current liabilities	3,798,729	3,333,117
Stockholders deficit		
Escrow receivable	(227,300)	(227,300)
Additional paid in capital	244,367	159,405
Common stock, no par value, authorized 100,000,000 shares; 35,730,119 and 34,706,917 shares issued and outstanding at June 30, 2002 and December 31, 2001, respectively	11,043,141	10,797,526
Accumulated deficit	(14,773,533)	(13,950,902)
Total stockholders deficit	(3,713,325)	(3,221,271)
	$ 85,404	$ 111,846

See notes to consolidated financial statements

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MEDICAL DISCOVERIES, INC. AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the Periods Ended June 30, 2002 and June 30, 2001, and Cumulative Amounts
(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,		Cumulative Amounts Since November 20, 1991 (Date of Inception)
	2002	2001	2002	2001	
Revenues	$	$	$	$	$ 134,104
Cost of goods sold					10,526
Gross profit					123,578
Research and development expenses				132,300	2,521,741
Inventory writedown					96,859
Impairment loss					9,709
License					1,001,500
General and administrative expenses	385,347	557,163	679,709	642,528	10,042,364
Operating loss	(385,347)	(557,163)	(679,709)	(774,828)	(13,548,595)
Other income (expense)					
Interest income					23,406
Other income	500		500		269,426
Interest expense	(121,317)	(45,739)	(143,422)	(89,924)	(565,233)
	(120,817)	(45,739)	(142,922)	(89,924)	(272,401)
Loss before income taxes and extraordinary item	(506,164)	(602,902)	(822,631)	(864,752)	(13,820,996)
Income taxes					
Forgiveness of debt net of $0 income taxes					1,235,536
Net loss available to shareholders	$ (506,164)	$ (602,902)	$ (822,631)	$ (864,752)	$ (12,585,460)
Net loss per share					
Continuing operations	$ (0.01)	$ (0.02)	$ (0.02)	$ (0.03)	$ (0.62)
Extraordinary item					0.06
Net loss per share	$ (0.01)	$ (0.02)	$ (0.02)	$ (0.03)	$ (0.56)
Weighted average shares outstanding	34,706,917	32,075,421	35,035,991	32,325,804	22,204,984

See accompanying notes

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MEDICAL DISCOVERIES, INC. AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Periods Ended June 30, 2002 (Unaudited) and June 30, 2001 (Unaudited), and Cumulative Amounts

	For the Six Months Ended June 30,		Cumulative Amounts Since November 20,
	2002	2001	1991 (Date of Inception)
Cash flows from operating activities			
Net loss	$ (822,631)	$ (864,752)	$ (13,373,956)
Adjustments to reconcile net loss to net cash used by operating activities			
Common stock options issued for services	84,962		2,801,257
Common stock issued for services, expenses, and litigation	117,011	64,120	3,942,596
Reduction of escrow receivable from research and development		132,300	272,700
Reduction of legal costs			(130,000)
Notes payable issued for litigation		385,000	385,000
Depreciation	679	2,658	100,271
Write-off of subscription receivables			112,500
Impairment loss on assets			9,709
Loss on disposal of equipment			30,364
Gain on debt restructuring			(1,235,536)
Write-off of receivables			193,965
Changes in assets and liabilities			
Deferred charges	24,153		(84,533)
Accounts receivable			(7,529)
Inventory			
Other assets			
Accounts payable	343,774	20,551	2,020,205
Accrued expenses	45,441	89,924	346,782
Net cash used by operating activities	(206,611)	(170,199)	(4,616,205)
Cash flows from investing activities			
Purchase of equipment			(132,184)
Payments received on note receivable			130,000
Net cash used by investing activities			(2,184)
Cash flows from financing activities			
Contributed equity			131,374
Issuance of common stock			3,354,359
Payments on notes payable		(35,000)	(206,287)
Proceeds from notes payable		200,000	916,613
Payments on convertible notes payable			(98,500)
Proceeds from convertible notes payable	205,001		521,701
Net cash provided by financing activities	205,001	165,000	4,619,260
Net increase (decrease) in cash	(1,610)	(5,199)	871
Cash, beginning of period	2,481	19,781	

Cash, end of period	$ 871	$ 14,582	$ 871
Supplemental disclosure of non-cash activities			
Repayment of accrued interest through issuance of common stock	$ 45,104	$	
Retirement of notes payable through issuance of common stock	$ 83,500	$	
Conversion of notes payable to common stock	$	$ 19,090	

See notes to consolidated financial statements

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MEDICAL DISCOVERIES, INC. AND SUBSIDIARIES
(A Development Stage Company)
NOTES TO UNAUDITED FINANCIAL STATEMENTS
June 30, 2002

Note 1. Unaudited Interim Financial Statements.

The accompanying unaudited financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all adjustments and disclosures necessary to a fair presentation of these financial statements have been included. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s 2001 Annual Report on Form 10-KSB for the year ended December 31, 2001, as filed with the Securities and Exchange Commission. Certain reclassifications and other corrections for rounding have been made in prior period financial statements to conform to the current period presentation. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation.

Note 2. Going Concern Considerations.

The Company s recurring losses from the Company s development-stage activities in current and prior years raise substantial doubt about the Company s ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible effects on the recoverability and classification of assets or amounts and classifications of liabilities that may result from the possible inability of the Company to continue as a going concern. The Company is attempting to raise additional capital to sustain operations. However, there can be no assurance that these plans will be successful.

Note 3. Commitment Regarding Peregrine Stock.

Peregrine Properties, LLC, a Utah limited liability company (Peregrine), has entered into an agreement to provide $500,000 to the Company to fund testing and research steps necessary to continue development of MDI-P. The studies are funded through an escrow agent. As of December 31, 2000, the Company had deposited in escrow a single certificate for 5.5 million shares of common stock for these purposes. Through June 30, 2002, Peregrine had funded $275,800 to the escrow, of which $272,700 had been disbursed and recorded as research and development expense on the financial statements of the Company. The remaining $227,300 to be expended under the agreement has been recorded on the balance sheet in equity under the caption escrow receivable. As expenditures are made from the escrow for research and development, the expenses are recorded on the books of the Company with a corresponding reduction in the escrow receivable. Under the original agreement, upon completion of the studies, the escrow agent was to disburse the 5.5 million shares to Peregrine and to disburse the research results to the Company. On March 22, 2002, the parties entered into an agreement the result of which was to partially close the escrow agreement to the extent of Peregrine s funding to date. On that date, 3,143,800 shares were distributed to Peregrine and all research conducted to date was disbursed to the Company. Additional research is ongoing, which will be funded by the remaining commitment from Peregrine.

Note 4. Subsequent Event Regarding Conversion of Harvest Note.

As of November 14, 2001, the Company settled its ongoing dispute with Harvest Group, L.L.C. (Harvest). Under the settlement, the Company delivered to Harvest a non-interest bearing, convertible promissory note (the Note) in the principal sum of $500,000 due on July 8, 2002 (the Due Date) in full satisfaction of all current amounts owning on loans from Harvest and all of Harvest s other claims against the Company. The Note has been recorded under current liabilities convertible notes payable on the June 30, 2002 balance sheet.

Subsequent to June 30, the Company did not repay any portion of the Note as of the Due Date. Therefore, under the terms of the Note, the unpaid principal amount due was automatically converted to the right to receive 17,116,337 unregistered shares of common stock of the Company. Harvest has tendered the original Note to the Company and the Company has instructed its transfer agent to issue a certificate to Harvest.

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

The purpose of this section is to discuss and analyze the Company s consolidated financial condition, liquidity and capital resources, and results of operations. This analysis should be read in conjunction with the financial statements and notes thereto at pages 2 through 7 and Management s Discussion and Analysis of Financial Condition and Results of Operations contained in the Company s Annual Report on Form 10-KSB for the year ended December 31, 2001 (the 2001 10-KSB).

This section contains certain forward-looking statements that involve risks and uncertainties, including statements regarding the Company s plans, objectives, goals, strategies and financial performance. The Company s actual results could differ materially from the results anticipated in these forward-looking statements as a result of factors set forth under Cautionary Statement for Forward-Looking Information below and elsewhere in this report.

Overview

Medical Discoveries, Inc. (the Company or MDI) has developed a product (hereafter MDI-P) that appears to have the ability to destroy certain viruses, bacteria and fungi, including the HIV virus. MDI-P may also have the ability to kill other infectious agents, possibly including pathogenic fungi and parasites. MDI-P may possibly be used as a sterilizing agent for medical and dental instruments. MDI-P may also potentially be used to remove or inactivate infectious agents in human and animal blood-derived products such as plasma and gamma globulin.

MDI-P is produced by the electrolysis of saline, using a patented instrument with proprietary electrodes. This solution has a significant oxidation reduction potential due to a mixture of oxidative products resulting from electrolysis.

Electrolysis is the method whereby a certain type of electric current is passed through a chemical solution. The electrical current causes the chemicals in the saline solution to alter, producing a variety of chemical compounds, such as ozone and hypochlorous acid. Different electrical currents produce different concentrations of these and related chemicals. In published scientific literature, electrolyzed saline solutions have been shown to have an intense anti-microbicidal effect.

The Company is committed to its pursuit of establishing MDI-P as an effective anti-bacterial, anti-viral and anti-fungal pharmaceutical for in-vitro and in-vivo applications and to developing MDI-P as an effective liquid chemical sterilant for a variety of applications.

MDI is a development stage company. To date, the Company has not generated significant revenues from operations or realized a profit. The Company is presently investing all of its resources in the testing, development and commercialization of MDI-P and its other technologies. The Company is attempting to raise additional funding to continue development of its technologies and to submit its technologies to appropriate regulatory agencies to secure approvals when required for the marketing and use of its products.

Recent Events

Conversion of Harvest Group Promissory Note. On July 8, 2002, the $500,000 convertible promissory note (the Note) made by the Company in favor of Harvest Group, L.L.C. (Harvest) automatically converted to the right to receive 17,116,337 unregistered shares of common stock of the Company. The Note was made as of November 14, 2001 to settle previously-reported litigation between Harvest and the Company. The Company did not repay any of the principal amount of the Note as of the maturity date (July 8, 2002), which triggered the Notes automatic conversion provision. Harvest has tendered the original Note to the Company and the Company has instructed its transfer agent to issue the shares due. Upon issuance of the 17,116,337 shares, Harvest will own 30% of the outstanding stock of the Company on a fully-diluted basis.

Euronet International Advisory Agreement. As previously reported, on March 26, 2002, the Company entered into an Advisory Agreement with Euronet International, Inc., a New York City-based business and financial advisory firm. The Advisory Agreement had a 12-month term, subject to early termination by the Company if certain milestones are not satisfied. Euronet has failed to achieve any of the milestones and the Company terminated the

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Advisory Agreement as of August 8, 2002.

Employment Agreement with Judy Robinett. On or about August 12, 2002, the Company and its CEO, Judy Robinett, entered into an Employment Agreement dated effective May 15, 2002, a copy of which is attached hereto as Exhibit 10.4. Under the terms of the Employment Agreement, Ms. Robinett is due a signing bonus of $200,000 and is to receive a salary of $200,000 per year. Prior to entering into the Employment Agreement, Ms. Robinett s salary was $180,000 per year.

Adoption of 2002 Stock Incentive Plan. On July 11, 2002, the Company s Board of Directors adopted the 2002 Stock Incentive Plan, a copy of which is attached hereto as Exhibit 10.5.

Results of Operations

Revenues and Gross Profit. The Company booked no revenue for the quarter ended June 30, 2002, nor was any revenue booked for the quarter ended June 30, 2001. The Company does not anticipate booking significant revenues in the near future as it continues to focus on getting products to market.

Operating Expenses and Operating Loss. The Company did not spend any funds on research and development for the quarter ended June 30, 2002, nor were any such funds expended during the same quarter of 2001. The Company s general and administrative expenses were $385,347 during the second quarter of 2002, as compared to $557,163 during the quarter ended June 30, 2001. As a result of the foregoing, the Company sustained an operating loss of $385,347 for the quarter ended June 30, 2002, as compared with an operating loss of $557,163 for the same period of 2001. Year-to-date, the Company s general and administrative expenses and resulting operating loss were $679,709. By comparison, the Company booked $642,528 in general and administrative expenses and $132,300 in research and development expenses resulting in an operating loss of $774,828 in the first 6 months of 2001.

Other Income/Expense and Net Loss. The Company booked $500 of other income and incurred interest expenses of $121,317 for the quarter ended June 30, 2002, as compared with no income and $45,739 in interest expenses for the same period of 2001. The increase in interest expense reflects the need for the Company to use high interest notes to continue operations. In sum, the Company s net loss for the second quarter of 2002 was $506,164 or a loss of $0.01 per fully diluted share. For the quarter ended June 30, 2001, the Company incurred a net loss of $602,902, a loss of nearly $0.02 per fully diluted share. For the six months ended June 30, 2002, the Company incurred a net loss of $822,631, or $0.02 per fully diluted shares, as compared with a net loss of $864,752 or $0.03 per share for the same period of 2001.

Future Expectations. Management expects the Company will operate at a loss for several more years while it continues to study, gain regulatory approval of and commercialize its technologies. If the Company is successful in raising additional capital, the Company will likely spend more during the remainder of 2002 in research and development and general and administrative expenses, and thereby sustain greater resulting losses, than it has in recent years.

Liquidity and Capital Resources

The Company will require significant additional funding to continue to develop, research and seek regulatory approval of its technologies. In addition, the Company cannot survive, even in the near term, without immediate additional funding for operations. The Company does not currently generate any cash from operations and has no credit facilities in place or available. Currently, the Company is funding operations through short-term loans from shareholders and others.

Management is seeking to raise substantial additional funds in private stock offerings in order to meet its near-term and long-term funding requirements. While management is optimistic that it can raise such funds, the Company has not always been successful in doing so in recent years. Given that the Company is still in an early development stage and does not have revenues from operations, raising equity financing is difficult. In addition, any additional equity financing will have a substantial dilutive effect to the Company s current shareholders.

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Cautionary Statement for Forward Looking Information

Certain information set forth in this report contains forward-looking statements within the meaning of federal securities laws. Forward looking statements include statements concerning plans, objectives, goals, strategies, future events, future revenues or performance, capital expenditures, and financing needs of the Company and other information that is not historical information. When used in this report, the words estimates, expects, anticipates, forecasts, plans, intends, believes and variations of such words or similar expressions are intended to identify forward-looking statements. Additional forward-looking statements may be made by the Company from time to time. All such subsequent forward-looking statements, whether written or oral and whether made by or on behalf of the Company, are also expressly qualified by these cautionary statements.

The Company s forward-looking statements are based upon the Company s current expectations and various assumptions. The Company s expectations, beliefs and projections are expressed in good faith and are believed by the Company to have a reasonable basis, including without limitation, management s examination of historical operating trends, data contained in the Company s records and other data available from third parties, but there can be no assurance that management s expectations, beliefs and projections will result or be achieved or accomplished. The Company s forward-looking statements apply only as of the date made. The Company undertakes no obligation to publicly update or revise forward-looking statements which may be made to reflect events or circumstances after the date made or to reflect the occurrence of unanticipated events.

There are a number of risks and uncertainties that could cause actual results to differ materially from those set forth in, contemplated by or underlying the forward-looking statements contained in this report. Those risks and uncertainties include, but are not limited to, our lack of significant operating revenue to date, our need for substantial and immediate additional capital, the fact that we may dilute existing shareholders through additional stock issuances, the extensive governmental regulation to which we are subject, the fact that our technologies remain unproven, the intense competition we face from other companies and other products, and our reliance upon potentially inadequate intellectual property. Those risks and certain other uncertainties are discussed in more detail in the 2001 10-KSB. There may also be other factors, including those discussed elsewhere in this report, that may cause the Company s actual results to differ from the forward-looking statements. Any forward-looking statements made by or on behalf of the Company should be considered in light of these factors.

PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. CHANGES IN SECURITIES

(c) The Company sold the following securities during the period covered by this report:

(i) $50,000 convertible promissory note dated April 8, 2002, convertible to common stock of the Company at the rate of $.125 per share.

(ii) $50,000 convertible promissory note dated April 21, 2002, convertible to common stock of the Company at the rate of $0.125 per share.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

The following documents are furnished as exhibits to this Form 10-KSB. Exhibits marked with an asterisk are filed herewith. The remainder of the exhibits previously have been filed with the Commission and are incorporated herein by reference.

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NUMBER	EXHIBIT
3.1	Amended and Restated Articles of Incorporation of the Company (filed as Exhibit 3.1 to the Company s Annual Report on Form 10-KSB for the fiscal year ended December 31, 1994, and incorporated herein by reference).
3.2	Amended Bylaws of the Company (filed as Exhibit 3.2 to the Company s Annual Report on Form 10-KSB for the fiscal year ended December 31, 1994, and incorporated herein by reference).
10.1	JV Agreement dated as of June 28, 2000, among Medical Discoveries, Inc., Harvest Group, L.L.C. and Hydromedics, Inc. (f/k/a Advanced Sales Company, Inc.) (filed as Exhibit 10.1 to the Company s Quarterly Report on Form 10-QSB for the quarter ended September 30, 2000, and incorporated herein by reference).
10.2	Mutual Release and Settlement Agreement dated as of November 29, 2001, among Medical Discoveries, Inc., Harvest Group, L.L.C. and Hydromedics, Inc. (f/k/a Advanced Sales Company, Inc.) (filed as Exhibit 10 to the Company s Current Report on Form 8-K on December 15, 2000, and incorporated herein by reference).
10.3	Advisory Agreement dated as of March 26, 2002, between Medical Discoveries, Inc. and Euronet International, Inc. (filed as Exhibit 10.3 to the Company s Annual Report on Form 10-KSB for the fiscal year ended December 31, 2001, and incorporated herein by reference).
10.4	Employment Agreement dated as of May 15, 2002 between Medical Discoveries, Inc. and Judy M. Robinett.*
10.5	2002 Stock Incentive Plan (adopted by the Board of Directors as of July 11, 2002).*
16.1	Letter from Tanner + Co. dated December 15, 2000 (filed as Exhibit 99 to the Company s Current Report on Form 8-K on December 15, 2000, and incorporated herein by reference).
16.2	Letter from Tanner + Co. dated January 4, 2001 (filed as Exhibit 16 to the Company s Current Report on Form 8-K/A on January 4, 2001, and incorporated herein by reference).
99	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

* Filed herewith

(b) Reports on Form 8-K.

The Company filed no reports on Form 8-K during the quarter ended June 30, 2002.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MEDICAL DISCOVERIES, INC.

/S/ JUDY M. ROBINETT

Judy M. Robinett
Chief Executive Officer

Date: August 14, 2002

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