

Supplement No. 1  
(To prospectus dated May 7, 2010)

**BioDrain Medical, Inc.**  
13,030,747 Shares of Common Stock  
\$0.01 par value

**This prospectus supplement No. 1 supplements and amends the prospectus dated May 7, 2010 (the "Prospectus"). This prospectus supplement should be read in conjunction with the Prospectus and may not be delivered or utilized without the Prospectus.**

On May 17, 2010, BioDrain Medical, Inc. filed with the Securities and Exchange Commission its quarterly report for the quarter ended March 31, 2010.

The date of this prospectus supplement No. 1 is May 17, 2010.

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2010

or

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

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

Commission File Number: Registration Statement No. 333-155299

BioDrain Medical, Inc.

(Exact name of registrant as specified in its charter)

Minnesota

(State or other jurisdiction of incorporation or organization)

33-1007393

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

2060 Centre Pointe Blvd., Suite 7,  
(Address of principal executive offices)

Mendota Heights, MN 55120  
(Zip Code)

651-389-4800

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, anon-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of May 11, 2010 the Company had 12,124,611 common shares, par value \$.01 per share, outstanding.

|   |    |
|---|----|
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**BIODRAIN MEDICAL, INC.**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONDENSED BALANCE SHEETS**  
**(Unaudited)**

|  | <u>March 31,</u><br><u>2010</u> | <u>December 31,</u><br><u>2009</u> |
|--|---------------------------------|------------------------------------|
| <u>ASSETS</u>  |                                 |                                    |
| Current Assets:  |                                 |                                    |
| Cash   | \$ 40,612                       | \$ 16,632                          |
| Accounts receivable  | -                               | 15,737                             |
| Prepaid expense and other assets   | 4,524                           | 3,801                              |
| Restricted cash in escrow (See Note 4)   | 67,833                          | 103,333                            |
| <b>Total Current Assets</b>  | <u>112,969</u>                  | <u>139,503</u>                     |
| Fixed assets, net  | 8,653                           | 9,260                              |
| Intangibles, net   | 141,532                         | 141,532                            |
| <b>Total Assets</b>  | <u>\$ 263,154</u>               | <u>\$ 290,295</u>                  |
| <u>LIABILITIES AND SHAREHOLDERS' DEFICIT</u>   |                                 |                                    |
| Current Liabilities:   |                                 |                                    |
| Current portion of long term debt (See Note 8)   | \$ 213,620                      | \$ 13,620                          |
| Current portion of convertible debt  | 50,000                          | 50,000                             |
| Accounts payable   | 808,759                         | 814,137                            |
| Shares due investors under registration payment arrangement                                    | 355,124                         | 355,124                            |
| Accrued expenses   | 209,940                         | 201,490                            |
| Convertible debenture  | 10,000                          | 10,000                             |
| <b>Total Current Liabilities</b>   | <u>1,647,443</u>                | <u>1,444,371</u>                   |
| Long term debt and convertible debt, net of discounts<br>of \$39,092 and \$44,873 (See Note 8) | 118,371                         | 116,108                            |
| Liability for equity-linked financial instruments (See Note 11)                                | 984,851                         | 1,071,847                          |
| Stockholders Deficit:  |                                 |                                    |
| Common stock, \$.01 par value, 40,000,000 authorized, 11,931,761 and 11,383,211 outstanding    | 119,318                         | 113,831                            |
| Additional paid-in capital   | 4,174,043                       | 3,573,506                          |
| Deficit accumulated during development stage   | (6,780,872)                     | (6,029,368)                        |
| <b>Total Shareholder' Deficit</b>  | <u>(2,487,511)</u>              | <u>(2,342,031)</u>                 |
| <b>Total Liabilities and Shareholders' Deficit</b>   | <u>\$ 263,154</u>               | <u>\$ 290,295</u>                  |

See Notes to Condensed Financial Statements

**BIODRAIN MEDICAL, INC.**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONDENSED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

|  | <b>Three Months Ended March 31,</b> |                | <b>Period From<br/>April 23, 2002<br/>(Inception)<br/>To March 31,</b> |
|--|-------------------------------------|----------------|--|
|  | <b>2010</b>                         | <b>2009</b>    | <b>2010</b>  |
| Revenue  | \$ 288                              | \$ -           | \$ 16,025  |
| Cost of goods sold   | 140                                 |                | 7,140  |
| Gross margin   | 148                                 | -              | 8,885  |
| General and administrative expense                                 | 712,135                             | 266,905        | 4,740,562  |
| Operations expense   | 64,735                              | 124,313        | 965,609  |
| Sales and marketing expense  | 73,052                              | 102,879        | 529,228  |
| Interest expense   | 14,279                              | 14,865         | 303,919  |
| Loss (gain) on valuation of equity-linked<br>financial instruments | (112,549)                           | 496,502        | 250,439  |
| Total expense  | 751,652                             | 1,005,464      | 6,789,757  |
| Net loss available to<br>common shareholders                       | \$ (751,504)                        | \$ (1,005,464) | \$ (6,780,872)   |
| Loss per common share<br>basic and diluted                         | \$ (0.06)                           | \$ (0.12)      | \$ (2.55)  |
| Weighted average shares used in<br>computation, basic and diluted  | 11,756,647                          | 8,147,508      | 2,661,163  |

See Notes to Condensed Financial Statements

**BIODRAIN MEDICAL, INC.**  
**(A DEVELOPMENT STAGE COMPANY)**  
**STATEMENT OF STOCKHOLDERS' DEFICIT**  
**(Unaudited)**  
**PERIOD FROM APRIL 23, 2002 (INCEPTION)**  
**TO MARCH 31, 2010**

|   | Shares     | Amount     | Paid in Capital | Deficit        | Total          |
|---|------------|------------|-----------------|----------------|----------------|
| Issuance of common stock 9/1/02, \$.0167 (1)                                | 598,549    | \$ 5,985   | \$ 4,015        | \$ -           | \$ 10,000      |
|   |            |            |                 |                | -              |
| Issuance of common 10/23/02, \$1.67/share                                   | 2,993      | 30         | 4,970           |                | 5,000          |
| Net loss  |            |            |                 | (51,057)       | (51,057)       |
| Balance 12/31/02  | 601,542    | \$ 6,015   | \$ 8,985        | \$ (51,057)    | \$ (36,057)    |
| Issuance of common 2/12/03, \$.0167 (2)                                     | 23,942     | 239        | 161             |                | 400            |
| Issuance of common 6/11&12,\$1.67 (3)                                       | 21,548     | 216        | 34,784          |                | 35,000         |
| Net Loss  |            |            |                 | (90,461)       | (90,461)       |
| Balance 12/31/03  | 647,032    | \$ 6,470   | \$ 43,930       | \$ (141,518)   | \$ (91,118)    |
| Issuance of common 5/25/04, \$.0167 (4)                                     | 6,567      | 66         | 44              |                | 110            |
| Net Loss  |            |            |                 | (90,353)       | (90,353)       |
| Balance 12/31/04  | 653,599    | \$ 6,536   | \$ 43,974       | \$ (231,871)   | \$ (181,361)   |
| Issuance of common 12/14/05, \$.0167 (5)                                    | 14,964     | 150        | 100             |                | 250            |
| Vested stock options and warrants   |            |            | 2,793           |                | 2,793          |
| Net Loss  |            |            |                 | (123,852)      | (123,852)      |
| Balance 12/31/05  | 668,563    | \$ 6,686   | \$ 46,867       | \$ (355,723)   | \$ (302,170)   |
| Issuance of common 5/16 & 8/8, \$.0167 (6)                                  | 86,869     | 869        | 582             |                | 1,451          |
| Issuance of common 10/19 & 23, \$.0167 (7)                                  | 38,906     | 389        | 261             |                | 650            |
| Issuance of common 12/01, \$1.67 (8)  | 28,739     | 287        | 44,523          |                | 44,810         |
| Vested stock options and warrants   |            |            | 13,644          |                | 13,644         |
| Net Loss  |            |            |                 | (273,026)      | (273,026)      |
| Balance 12/31/06  | 823,077    | \$ 8,231   | \$ 105,877      | \$ (628,749)   | \$ (514,641)   |
| Issuance of common 1/30/07 @ 1.67 (9)                                       | 599        | 6          | 994             |                | 1,000          |
| Value of equity instruments issued with debt                                |            |            | 132,938         |                | 132,938        |
| Capital contributions resulting from waivers of debt                        |            |            | 346,714         |                | 346,714        |
| Vested stock options and warrants   |            |            | 73,907          |                | 73,907         |
| Net loss  |            |            |                 | (752,415)      | (752,415)      |
| Balance 12/31/07  | 823,676    | \$ 8,237   | \$ 660,430      | \$ (1,381,164) | \$ (712,497)   |
| Issuance of common 6/11 to 9/30, \$.35 (10)                                 | 4,552,862  | 45,528     | 1,547,974       |                | 1,593,502      |
| Shares issued to finders, agents  | 2,012,690  | 20,127     | (20,127)        |                | -              |
| Shares issued to pay direct legal fees                                      | 285,714    | 2,857      | (2,857)         |                | -              |
| Issuance of common due to antidilution provisions                           | 205,899    | 2,059      | (2,059)         |                | -              |
| Shares issued to pay investor relations services 6/23/08, \$.35             | 250,000    | 2,500      | 85,000          |                | 87,500         |
| Vested stock options and warrants   |            |            | 354,994         |                | 354,994        |
| Capital contributions resulting from waivers of debt                        |            |            | 129,684         |                | 129,684        |
| Net loss  |            |            |                 | (1,762,628)    | (1,762,628)    |
| Balance 12/31/08  | 8,130,841  | \$ 81,308  | \$ 2,753,039    | \$ (3,143,792) | \$ (309,445)   |
| Cumulative effect of adoption of EITF 07-5                                  |            |            | (486,564)       | 6,654          | (479,910)      |
| Vested stock options and warrants   |            |            | 111,835         |                | 111,835        |
| Shares issued 3/20/09 to pay for fund raising                               | 125,000    | 1,250      | (1,250)         |                | -              |
| Shares issued under PMM in April 2009, \$.50                                | 700,000    | 7,000      | 343,000         |                | 350,000        |
| Shares issued under PPM in May 2009, \$.50                                  | 220,000    | 2,200      | 107,800         |                | 110,000        |
| Shares issued under PPM in June 2009, \$.50                                 | 50,000     | 500        | 24,500          |                | 25,000         |
| Shares issued under PPM in August 2009, \$.50                               | 80,000     | 800        | 39,200          |                | 40,000         |
| Shares issued under PPM in September 2009, \$.50                            | 150,000    | 1,500      | 73,500          |                | 75,000         |
| Shares issued to directors, management and consultant in August 2009, \$.50 | 797,810    | 7,978      | 390,927         |                | 398,905        |
| Shares issued to finder in September 2009, \$.50                            | 100,000    | 1,000      | 49,000          |                | 50,000         |
| Capital contributions resulting from waivers of debt                        |            |            | 84,600          |                | 84,600         |
| Value of equity-linked financial instruments issued in connection with PPMs |            |            | (222,296)       |                | (222,296)      |
| Value of equity instruments issued with debt                                |            |            | 30,150          |                | 30,150         |
| Shares issued to consultant for fund raising                                | 30,000     | 300        | (300)           |                | -              |
| Shares issued under PPM in November 2009, \$.50                             | 50,000     | 500        | 24,500          |                | 25,000         |
| Shares issued upon conversion of debt and interest, \$.27                   | 935,446    | 9,355      | 247,099         |                | 256,454        |
| Shares issued upon conversion of shareholder note, \$.35                    | 14,024     | 140        | 4,766           |                | 4,906          |
| Net Loss  |            |            |                 | (2,892,230)    | (2,892,230)    |
| Balance 12/31/09  | 11,383,121 | \$ 113,831 | \$ 3,573,505    | \$ (6,029,368) | \$ (2,342,031) |

|   |                   |                   |                     |                       |
|---|-------------------|-------------------|---------------------|-----------------------|
| Shares issued in March 2010 under PPM, \$.50                                  | 174,550           | 1,746             | 85,529              | 87,275                |
| Shares issued to consultants for IR and consulting, \$.50                     | 374,090           | 3,741             | 183,304             | 187,045               |
| Vested stock options and warrants   |                   |                   | 2,656               | 2,656                 |
| Value of equity instruments issued for consulting services                    |                   |                   | 354,602             | 354,602               |
| Value of equity-linked financial instruments issued<br>in connection with PPM |                   |                   | (25,553)            | (25,553)              |
| Net Loss  |                   |                   | (751,504)           | (751,504)             |
| Balance 3/31/2010   | <u>11,931,761</u> | <u>\$ 119,318</u> | <u>\$ 4,174,043</u> | <u>\$ (6,780,872)</u> |
|   |                   |                   |                     | <u>\$ (2,487,511)</u> |

- (1) Founders shares, 1,000,000 pre-split
- (2) 23,492 (40,000 pre-split) shares valued at \$.0167 per share as compensation for loan guarantees by management
- (3) Investment including 670 shares issued as a 10% finders fee
- (4) For payment of patent legal fees
- (5) Compensation for loan guarantees by management
- (6) For vendor contractual consideration
- (7) Employment agreements
- (8) Investment
- (9) Conversion of convertible notes by management
- (10) Investment, "October 2008 financing".

See Notes to Condensed Financial Statements

**BIODRAIN MEDICAL, INC.**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONDENSED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

|   | Three Months<br>Ended March 31, |                | April 23,<br>2002<br>(Inception)<br>To March 31,<br>2010 |
|---|---------------------------------|----------------|--|
|   | 2010                            | 2009           | 2010   |
| <b>Cash flow from operating activities:</b>                                 |                                 |                |  |
| Net loss  | \$ (751,504)                    | \$ (1,005,464) | \$ (6,780,872)   |
| Adjustments to reconcile net loss to net cash used in operating activities: |                                 |                |  |
| Depreciation  | 607                             | 1,220          | 4,568  |
| Vested stock options and warrants   | 2,656                           | 32,431         | 559,809  |
| Equity instruments issued for management and consulting services            | 541,647                         |                | 1,078,052  |
| Stock based registration payments   | -                               |                | 355,124  |
| Conversion of accrued liabilities to capital                                | -                               |                | 560,998  |
| Amortization of debt discount   | 5,781                           | 2,514          | 123,997  |
| (Gain) Loss on valuation of equity-linked instruments                       | (112,549)                       | 496,502        | 250,439  |
| Changes in assets and liabilities:  |                                 |                |  |
| Accounts receivable   | 15,737                          | -              | -  |
| Prepaid expense and other   | (723)                           | 2,533          | (4,524)  |
| Notes payable to shareholders   | -                               | -              | (14,957)   |
| Accounts payable  | (5,380)                         | 118,862        | 808,757  |
| Accrued expenses  | 8,450                           | 14,946         | 209,941  |
| Net cash used in operating activities:                                      | (295,278)                       | (336,456)      | (2,848,668)  |
| <b>Cash flow from investing activities:</b>                                 |                                 |                |  |
| Purchase of fixed assets  | -                               | -              | (12,258)   |
| Purchase of intangibles   | -                               | -              | (142,495)  |
| Net cash used in investing activities                                       | -                               | -              | (154,753)  |
| <b>Cash flow from financing activities:</b>                                 |                                 |                |  |
| Proceeds from long term and convertible debt                                | 200,000                         |                | 721,505  |
| Principal payments on long term debt  | (3,517)                         | (3,325)        | (275,447)  |
| Restricted cash in escrow   | 35,500                          |                | (67,833)   |
| Debt converted to common stock  | -                               | -              | 174,000  |
| Accrued interest converted to stock   | -                               |                | 87,360   |
| Issuance of common stock  | 87,275                          |                | 2,404,448  |
| Net cash provided by (used in) financing activities                         | 319,258                         | (3,325)        | 3,044,033  |
| Net increase (decrease) in cash   | 23,980                          | (339,781)      | 40,612   |
| Cash at beginning of period   | 16,632                          | 463,838        | -  |
| Cash at end of period   | \$ 40,612                       | \$ 124,057     | \$ 40,612  |

See Notes to Condensed Financial Statements



**NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Nature of Operations and Continuance of Operations**

BioDrain Medical, Inc. was incorporated under the laws of the State of Minnesota in 2002. The Company is developing an environmentally safe system for the collection and disposal of infectious fluids that result from surgical procedures and post-operative care.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The company has suffered recurring losses from operations and has a stockholders' deficit. These factors raise substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Management hired an investment banker in January 2010 to raise an additional \$3-\$5 million in new equity. The banker has been unable to raise the expected \$500,000 by March 31, 2010 but we have raised approximately \$287,000 in 2010 and are planning to close on a bigger round within the next 30 days. Although our ability to raise this new capital is in substantial doubt we received \$725,000 through private placements of equity and convertible debt in 2009, and our April 1, 2009 510(k) clearance from the FDA to authorize us to market and sell our FMS products is being received very positively. If the Company is successful in raising at least \$3 million in new equity we will have sufficient capital to operate our business and execute our business plan for at least the next 12 months. If the Company raises the additional capital by issuing additional equity securities its shareholders could experience substantial dilution.

**Recent Accounting Developments**

Issued in January 2010, ASU Update 2010-06, Fair Value Measures and Disclosures, provides amendments to Topic 820 that will provide more robust disclosures about (1) the different classes of assets and liabilities measured at fair value, (2) the valuation techniques and inputs used, (3) the activity in level 3 fair value measurements, and (4) the transfers between levels 1, 2, and 3. ASC Update 2010-06 is effective for fiscal years beginning after December 15, 2010. We do not expect adoption of ASU Update 2010-06 to have a material effect to our financial statements or our disclosures.

Issued in October 2009, ASU Update 2009-13, Revenue Recognition Topic 605 - Multiple-Deliverable Revenue Arrangements provides guidance for separating consideration in multiple-deliverable arrangements. ASC Number 2009-13 is effective for fiscal years beginning on or after June 15, 2010. We do not expect adoption of ASU Update 2009-13 to have a material effect on our financial statements.

Effective February 2010, we adopted ASU Update 2010-09, Subsequent Events, which provides amendments to Topic 855 removing the requirement for SEC filers to disclose the date through which an entity has evaluated subsequent events. The adoption of ASU Update 2010-09 did not have a significant impact on our disclosures.

## **Accounting Estimates**

The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## **Presentation of Taxes Collected from Customers**

Sales taxes are imposed on the Company's sales to nonexempt customers. The Company collects the taxes from customers and remits the entire amounts to the governmental authorities. The Company's accounting policy is to exclude the taxes collected and remitted from revenues and expenses.

## **Shipping and Handling**

Shipping and handling charges billed to customers are recorded as revenue. Shipping and handling costs are recorded within cost of goods sold on the statement of operations.

## **Advertising**

Advertising costs are expensed as incurred. Total advertising expenses were approximately \$0 and \$1,600 in the three months ended March 31, 2010 and 2009, respectively.

## **Research and Development**

Research and development costs are charged to operations as incurred. Research and development costs were \$0 and \$600 in the three months ended March 31, 2010 and 2009, respectively.

## **Revenue Recognition**

We recognize revenue in accordance with the SEC's Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements*, as amended by Staff Accounting Bulletin No. 104 (together, SAB 101), and ASC 605 *Revenue Recognition*.

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed and determinable and collectability is probable. Delivery is considered to have occurred upon either shipment of the product or arrival at its destination based on the shipping terms of the transaction. Our standard terms specify that shipment is FOB BioDrain and we will, therefore recognize revenue upon shipment in most cases. This revenue recognition policy applies to shipments of our FMS units as well as shipments of cleaning solution kits. When these conditions are satisfied, we recognize gross product revenue, which is the price we charge generally to our customers for a particular product. Under our standard terms and conditions there is no provision for installation or acceptance of the product to take place prior to the obligation of the customer. The Customer's right of return is limited only to our standard warranty whereby we replace or repair, at our option, and it would be very rare that the unit or significant quantities of cleaning solution kits may be returned. Additionally, since we buy both the FMS units and cleaning solution kits from "turnkey" suppliers we would have the right to replacements from the suppliers if this situation should occur.

## **Receivables**

Receivables are reported at the amount the Company expects to collect on balances outstanding at year end. The Company has concluded there will be no losses on balances outstanding at year end and as of March 31, 2010.

## Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation of property and equipment is computed using the straight-line method over the estimated useful lives of the respective assets. Estimated useful asset life by classification is as follows:

|                                | Years |
|--------------------------------|-------|
| Computers and office equipment | 3     |
| Furniture and fixtures         | 5     |

Upon retirement or sale, the cost and related accumulated depreciation are removed from the balance sheet and the resulting gain or loss is reflected in operations. Maintenance and repairs are charged to operations as incurred.

## Intangible Assets

Intangible assets consist of patent costs. These assets are not subject to amortization until the property patented is in production. The assets are reviewed for impairment annually, and impairment losses, if any, are charged to operations when identified. No impairment losses have been identified by management.

## Income Taxes

The Company accounts for income taxes in accordance with ASC 740- *Income Taxes* (“ASC 740”). Under ASC 740, deferred tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities and net operating loss and credit carry forwards using enacted tax rates in effect for the year in which the differences are expected to impact taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. In June 2006, the FASB issued Interpretation 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”), which became effective for the Company beginning January 1, 2007. FIN 48, now included within ASC 740, addresses how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under ASC 740, the tax benefit from an uncertain tax position can be recognized only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. The Company has identified no income tax uncertainties.

## Patents and Intellectual Property

The Company, in June 2008, completed and executed an agreement to secure exclusive ownership of the patent from an inventor, Marshall Ryan. Mr. Ryan received a combination of cash and warrants, and he will receive a 4% royalty on FMS (the Product) sales for the life of the patent. At the signing of the agreement, Mr. Ryan received \$75,000 in exchange for the exclusive assignment of the patent. In addition, on June 30, 2009, Mr. Ryan, through his Mid-State Stainless, Inc. entity, was entitled to receive \$100,000 as payment (currently recorded as an account payable with the Company) for past research and development activities. Should Mr. Ryan be utilized in the future for additional product development activities, he will be compensated at a rate of ninety five dollars (\$95.00) per hour.

Mr. Ryan also received a warrant, with immediate vesting, to purchase 150,000 shares of our common stock at a price of \$.35 per share. The warrant has a term of five years, ending on June 30, 2013 and is assigned a value of \$28,060 using a Black-Scholes formula and this amount was expensed as consulting expense in 2008 using a five-year expected life, a 3.73% risk free interest rate, an expected 59% volatility and a zero dividend rate. Should there be a change in control of the Company (defined as greater than 50% of the Company’s outstanding stock or substantially all of its assets being transferred to one independent person or entity), Mr. Ryan will be owed a total of \$2 million to be paid out over the life of the patent if the change in control occurs within 12 months of the first sale of the Product; or \$1 million to be paid out over the life of the patent if the change in control occurs between 12 and 24 months of the first sale of the Product; or \$500,000 to be paid out over the life of the patent if the change in control occurs between 24 and 36 months of the first sale of the Product. There will be no additional payment if a change in control occurs more than 36 months after the first sale of the Product.

## Subsequent Events

The Company has evaluated all subsequent events through the date of this filing.

## Interim Financial Statements

The Company has prepared the unaudited interim financial statements and related unaudited financial information in the footnotes in accordance with accounting principles generally accepted in the United States of America ("GAAP") and the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial statements. These interim financial statements reflect all adjustments consisting of normal recurring accruals, which, in the opinion of management, are necessary to present fairly the Company's financial position, the results of its operations and its cash flows for the interim periods. These interim financial statements should be read in conjunction with the annual financial statements and the notes thereto contained in the Form 10-K filed with the SEC on March 31, 2010. The nature of the Company's business is such that the results of any interim period may not be indicative of the results to be expected for the entire year.

### NOTE 2 – DEVELOPMENT STAGE OPERATIONS

The Company was formed April 23, 2002. Since inception to March 31, 2010, 11,931,761 shares have been issued between par value and \$1.67. Operations since incorporation have been devoted to raising capital, obtaining financing, development of the Company's product, and administrative services.

### NOTE 3 – STOCKHOLDERS' DEFICIT, STOCK OPTIONS AND WARRANTS

In connection with the financing completed in October 2008, the Company has effected two reverse stock splits, one on June 6, 2008 and another on October 20, 2008. In accordance with SAB Topic 4C, all stock options and warrants and their related exercise prices are stated at their post-reverse stock split values.

The Company has an equity incentive plan, which allows issuance of incentive and non-qualified stock options to employees, directors and consultants of the Company, where permitted under the plan. The exercise price for each stock option is determined by the board of directors. Vesting requirements are determined by the board of directors when granted and currently range from immediate to three years. Options under this plan have terms ranging from three to ten years.

#### *Accounting for share-based payment*

Effective January 1, 2006, we adopted SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)) which replaced SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123) and superseded Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), all now codified under ASC 718- *Compensation-Stock Compensation* ("ASC 718). Under ASC 718 stock-based employee compensation cost is recognized using the fair value based method for all new awards granted after January 1, 2006 and unvested awards outstanding at January 1, 2006. Compensation costs for unvested stock options and non-vested awards that were outstanding at January 1, 2006, are being recognized over the requisite service period based on the grant-date fair value of those options and awards as previously calculated under SFAS 123 for pro forma disclosures, using a straight-line method. We elected the modified-prospective method in under which prior periods are not retroactively restated.

ASC 718 requires companies to estimate the fair value of stock-based payment awards on the date of grant using an option-pricing model or other acceptable means. We use the Black-Scholes option valuation model which requires the input of significant assumptions including an estimate of the average period of time employees will retain vested stock options before exercising them, the estimated volatility of our common stock price over the expected term, the number of options that will ultimately be forfeited before completing vesting requirements, the expected dividend rate and the risk-free interest rate. Changes in the assumptions can materially affect the estimate of fair value of stock-based compensation and, consequently, the related expense recognized. The assumptions we use in calculating the fair value of stock-based payment awards represent our best estimates, which involve inherent uncertainties and the application of management's judgment. As a result, if factors change and we use different assumptions, our equity-based compensation expense could be materially different in the future.

Since our company stock has no significant public trading history, and we have experienced no option exercises in our history, we were required to take an alternative approach to estimating future volatility and estimated life and the future results could vary significantly from our estimates. We compiled historical volatilities over a period of 2-7 years of 15 small-cap medical companies traded on major exchanges and 10 medical companies in the middle of the size range on the OTC Bulletin Board and combined the results using a weighted average approach. In the case of ordinary options to employees we determined the expected life to be the midpoint between the vesting term and the legal term. In the case of options or warrants granted to non-employees we estimated the life to be the legal term unless there was a compelling reason to make it shorter.

When an option or warrant is granted in place of cash compensation for services we deem the value of the service rendered to be the value of the option or warrant. In most cases, however, an option or warrant is granted in addition to other forms of compensation and its separate value is difficult to determine without utilizing an option pricing model. For that reason we also use the Black-Scholes-Merton option-pricing model to value options and warrants granted to non-employees, which requires the input of significant assumptions including an estimate of the average period the investors or consultants will retain vested stock options and warrants before exercising them, the estimated volatility of our common stock price over the expected term, the number of options and warrants that will ultimately be forfeited before completing vesting requirements, the expected dividend rate and the risk-free interest rate. Changes in the assumptions can materially affect the estimate of fair value of stock-based consulting and/or compensation and, consequently, the related expense recognized.

Since we have no trading history in our stock and no first-hand experience with how these investors and consultants have acted in similar circumstances, the assumptions we use in calculating the fair value of stock-based payment awards represent our best estimates, which involve inherent uncertainties and the application of management's judgment. As a result, if factors change and we use different assumptions, our equity-based consulting and interest expense could be materially different in the future.

*Valuation and accounting for options and warrants*

The Company determines the grant date fair value of options and warrants using a Black-Scholes-Merton option valuation model based upon assumptions regarding risk-free interest rate, expected dividend rate, volatility and estimated term. For grants during 2008 we used a 2.0 to 4.5% risk-free interest rate, 0% dividend rate, 53-66% volatility and estimated term of 2.5 to 7.5 years. Values computed using these assumptions ranged from \$.102 per share to \$.336 per share. Warrants or options awarded for services rendered are expensed over the period of service (normally the vesting period) as compensation expense for employees or an appropriate consulting expense category for awards to consultants and directors. Warrants granted in connection with a common equity financing are included in stockholders' equity, provided that there is no re-pricing provision that requires they be treated as a liability (See Note 11) and warrants granted in connections with a debt financing are treated as a debt discount and amortized using the interest method as interest expense over the term of the debt. Warrants issued in connection with the \$100,000 convertible debt, closed March 1, 2007, created a debt discount of \$40,242 that is being amortized as additional interest over its five-year term. Warrants issued in connection with the \$170,000 in convertible "bridge" debt, closed in July 2007, created a calculated debt discount of \$92,700 that was fully expensed over its loan term that matured April 30, 2008. The Company issued \$100,000 in convertible debt in October 2009 and issued a warrant, in connection with the debt, for 200,000 shares at \$.65 per share. The Company determined that the warrant had an initial value of \$30,150 that is treated as a debt discount and amortized as additional interest expense over the 24 month term of the note. The value was determined using the Black-Scholes-Merton option valuation model with a three-year expected life, a 54% expected volatility, a zero dividend rate and a 2.53% risk free interest rate.

The following summarizes transactions for stock options and warrants for the periods indicated:

|                                  | Stock Options (1) |                        | Warrants (1)     |                        |
|----------------------------------|-------------------|------------------------|------------------|------------------------|
|                                  | Number of Shares  | Average Exercise Price | Number of Shares | Average Exercise Price |
| Outstanding at December 31, 2005 | 17,956            | \$ 1.67                | 20,950           | \$ 2.62                |
| Issued                           | 23,942            | 1.67                   | 71,826           | 0.85                   |
| Outstanding at December 31, 2006 | 41,898            | \$ 1.67                | 92,776           | \$ 1.25                |
| Issued                           | 5,984             | 1.67                   | 28,502           | 0.35                   |
| Outstanding at December 31, 2007 | 47,882            | \$ 1.67                | 121,278          | \$ 1.04                |
| Issued                           | 1,243,292         | 0.20                   | 5,075,204        | 0.45                   |
| Expired                          |                   |                        | (11,971)         | 3.76                   |
| Outstanding at December 31, 2008 | 1,291,174         | \$ 0.26                | 5,184,511        | 0.45                   |
| Issued                           | 205,000           | 0.37                   | 2,188,302        | 0.65                   |
| Outstanding at December 31, 2009 | 1,496,174         | 0.27                   | 7,372,813        | 0.49                   |
| Issued                           | 150,000           | 0.50                   | 1,174,550        | 0.28                   |
| Outstanding at March 31, 2010    | 1,646,174         | 0.29                   | 8,547,363        | 0.46                   |

(1) Adjusted for the reverse stock splits in total at June 6, 2008 and October 20, 2008. There were no options or warrants exercised in the periods.

The weighted average grant date fair value of stock options granted through March 31, 2010 and the fair value of shares vesting in each year are as follows:

| Year  | Options   | Fair Value | Fair value vested |
|-------|-----------|------------|-------------------|
| 2005  | 17,956    | \$ 0.671   | \$ 1,673          |
| 2006  | 23,942    | \$ 0.682   | \$ 12,919         |
| 2007  | 5,984     | \$ 0.687   | \$ 71,038         |
| 2008  | 1,243,292 | \$ 0.232   | \$ 220,287        |
| 2009  | 205,000   | \$ 0.243   | \$ 52,272         |
| 2010  | 150,000   | 0.319      | 47,813            |
| Total | 1,646,174 | \$ 0.247   | \$ 406,002        |

At March 31, 2010, 1,504,506 stock options are fully vested and currently exercisable with a weighted average exercise price of \$.29 and a weighted average remaining term of 6.7 years. There are 8,367,363 warrants that are fully vested and exercisable. Stock based compensation recognized in the three months ended March 31, 2010 and 2009 544,000 and \$32,000, respectively. The following summarizes the status of options and warrants outstanding at March 31, 2010:

| Range of Exercise Prices | Shares           | Weighted<br>Average<br>Remaining<br>Life |
|--------------------------|------------------|--|
| <b>Options</b>           |                  |  |
| \$0.01                   | \$ 543,292       | \$ 8.18                                  |
| \$0.35                   | 875,000          | 3.36                                     |
| \$0.50                   | 180,000          | 8.64                                     |
| \$1.67                   | 47,882           | 1.25                                     |
| <b>Total</b>             | <b>1,646,174</b> |  |
| <b>Warrants</b>          |                  |  |
| \$0.02                   | 71,826           | 4.20                                     |
| \$0.10                   | 800,000          | 2.92                                     |
| \$0.35                   | 798,597          | 2.15                                     |
| \$0.46                   | 4,972,498        | 1.37                                     |
| \$0.65                   | 1,859,550        | 1.98                                     |
| \$1.67                   | 44,892           | 1.45                                     |
| <b>Total</b>             | <b>8,547,363</b> |  |

Stock options and warrants expire on various dates from August 2010 to February 2020.

Under terms of our agreement with investors in the October 2008 financing 1,920,000 shares of common stock were the maximum number of shares allocated to our existing shareholders at the time of the offering (also referred to as the original shareholders or the Founders). Since the total of our fully-diluted shares of common stock was greater than 1,920,000, in order for us to proceed with the offering, our board of directors approved a reverse stock split of 1-for-1.2545. After this split was approved, additional options and warrants were identified, requiring a second reverse stock split in order to reach the 1,920,000. The second reverse stock split on the reduced 1-for-1.2545 balance was determined to be 1-for-1.33176963. Taken together, if only one reverse stock were performed, the number would have been a reverse stock split of 1-for 1.670705.

On June 6, 2008, the Board of Directors approved the first reverse stock split. The authorized number of common stock of 20,000,000 was proportionately divided by 1.2545 to 15,942,607.

On October 20, 2008, the Board of Directors (i) approved the second reverse stock split pursuant to which the authorized number of shares of common stock of 15,942,607 was proportionately divided by 1.33177 to 11,970,994 and (ii) approved a resolution to increase the number of authorized shares of our common stock from 11,970,994 to 40,000,000, which was approved by the Company's shareholders holding a majority of the shares entitled to vote thereon at a special meeting of shareholders held on December 3, 2008.

#### Stock, Stock Options and Warrants Granted by the Company

The following table is the listing of stock options and warrants as of March 31, 2010 by year of grant:

| Stock Options:<br>Year | Shares           | Price                |
|------------------------|------------------|----------------------|
| 2005                   | 17,956           | \$ 1.67              |
| 2006                   | 23,942           | 1.67                 |
| 2007                   | 5,984            | .35-1.67             |
| 2008                   | 1,243,292        | .01-.35              |
| 2009                   | 205,000          | .35-.50              |
| 2010                   | 150,000          | .50                  |
| <b>Total</b>           | <b>1,646,174</b> | <b>\$ .01-\$1.67</b> |

|           |  |           |               |
|-----------|--|-----------|---------------|
| Warrants: |  |           |               |
| Year      |  | Shares    | Price         |
| 2005      |  | 8,979     | \$ 1.67       |
| 2006      |  | 71,826    | .02-1.67      |
| 2007      |  | 28,502    | .35           |
| 2008      |  | 5,075,204 | .02-.46       |
| 2009      |  | 2,188,302 | .35-.65       |
| 2010      |  | 1,174,550 | .10-.65       |
| Total     |  | 8,547,363 | \$ .02-\$1.67 |

#### NOTE 4 – RESTRICTED CASH IN ESCROW

Under terms of the escrow agreement established in connection with the October 2008 financing, certain amounts were to be withheld to pay legal, accounting and placement agent fees as well as to pay for investor relations activities that commenced upon receiving an effective registration of the Company's stock and an initial listing with the OTC Bulletin Board. All amounts related to legal, accounting and placement agent fees have been disbursed and the current balance is solely being held to fund investor relations activities.

During the fourth quarter of 2009, \$60,000 was released to pay for investor relations activities. Additionally, \$35,500 was released during the first quarter of 2010 to pay for accounting expenses. The balance in this escrow account will be expended on investor relations, accounting or legal activities or will be released to the Company if we should withdraw our public company registration or otherwise by mutual agreement of the investors who established the escrow as a condition of the October 2008 financing.

#### NOTE 5 – LOSS PER SHARE

The following table presents the shares used in the basic and diluted loss per common share computations:

|   | Three Months Ended<br>March 31, |                | From<br>April 23, 2002<br>(Inception) To<br>March 31, 2010 |
|---|---------------------------------|----------------|--|
|   | 2010                            | 2009           |  |
| Numerator   |                                 |                |  |
| Net Loss available in basic and diluted calculation | \$ (751,504)                    | \$ (1,005,464) | \$ (6,780,872)   |
| Denominator   |                                 |                |  |
| Weighted average common shares outstanding-basic    | 11,756,647                      | 8,147,508      | 2,661,163  |
| Effect of dilutive stock options and warrants (1)   | -                               | -              | -  |
| Weighted average common shares outstanding-diluted  | 11,756,647                      | 8,147,508      | 2,661,163  |
| Loss per common share-basic and diluted             | \$ (0.06)                       | \$ (0.12)      | \$ (2.55)  |

(1) The number of options and warrants outstanding as of March 31, 2010 and March 31, 2009 are 10,193,537 and 7,210,780 respectively. The effect of the shares that would be issued upon exercise has been excluded from the calculation of diluted loss per share because those shares are anti-dilutive.

#### NOTE 6 – INCOME TAXES

The provision for income taxes consists of an amount for taxes currently payable and a provision for tax consequences deferred to future periods. Deferred income taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

There is no income tax provision in the accompanying statement of operations due to the cumulative operating losses that indicate a 100% valuation allowance for the deferred tax assets and state income taxes is appropriate.

Federal and state income tax return operating loss carryovers as of March 31, 2010, were approximately \$6,166,000 and will begin to expire between 2017 and 2019.

The valuation allowance has been recorded due to the uncertainty of realization of the benefits associated with the net operating losses. Future events and changes in circumstances could cause this valuation allowance to change.

The components of deferred income taxes at March 31, 2010 and December 31, 2009 are as follows:

|                          | March 31,<br>2010 | December 31,<br>2009 |
|--------------------------|-------------------|----------------------|
| Deferred Tax Asset:      |                   |                      |
| Net Operating Loss       | \$ 1,440,000      | \$ 1,278,000         |
| Total Deferred Tax Asset | 1,440,000         | 1,278,000            |

|                           |    |           |    |           |
|---------------------------|----|-----------|----|-----------|
| Less Valuation Allowance  |    | 1,440,000 |    | 1,278,000 |
| Net Deferred Income Taxes | \$ | —         | \$ | —         |



## NOTE 7 – NOTES PAYABLE

The Company has a convertible debenture with Andcor Companies, Inc. (“Andcor”) of \$10,000 with interest at 10.25% that matured in 2007. The debenture is convertible to the Company’s common stock at the lower of \$0.90 per share or the price per share at which the next equity financing agreement is completed, and is now re-set to \$.35 per share. The convertible debenture has not yet been paid, and it is currently in default. While Andcor could demand payment on this note at any time, they have verbally expressed an interest in working with us to wait until additional funds are secured by the Company. Further, Andcor has left open the possibility of converting the note into shares of the Company’s common stock, which would require no cash outlay by the Company.

## NOTE 8 – LONG-TERM DEBT

Long-term debt is as follows:

|  | <u>March 31,<br/>2010</u> | <u>December 31,<br/>2009</u> |
|--|---------------------------|------------------------------|
| Note payable to bank in monthly installments of \$1,275, including variable interest at 2% above the prevailing prime rate (3.25% at March 31, 2010), to August 2011 when the remaining balance is payable. The note is personally guaranteed by former executives of the Company.                   | 21,084                    | 24,601                       |
| Notes payable to two individuals, net of discounts of \$15,426 and \$17,438, with interest only payments at 12% to March 2012 when the remaining balance is payable. The notes are convertible into 285,715 shares of stock in the Company at \$.35 per share.                                       | 82,562                    | 82,562                       |
| Note payable issued on October 26, 2009 to the parents of one our officers, net of a discount of \$23,666 and \$27,435 discount, with interest at 8% to October 26, 2011 and convertible into 200,000 shares of common stock at \$.50 per share.   | 76,334                    | 72,565                       |
| Notes payable issued to one company and two individuals in January, 2010. The notes bear interest at 8%, are due in October 2010 and are convertible into shares of common stock, at the election of the lender, at 50% of the weighted average trading price over a consecutive 10 days of trading. | 200,000                   | -                            |
| Total  | <u>381,991</u>            | <u>179,728</u>               |
| Less amount due within one year  | <u>263,620</u>            | <u>63,620</u>                |
| Long-Term Debt   | <u>\$ 118,371</u>         | <u>\$ 116,108</u>            |

Cash payments for interest were \$1,718 for the year ended December 31, 2009 and \$292 for the three months ended March 31, 2010. The convertible debenture of \$10,000 (discussed in Note 7), is delinquent and could be called by the holders, putting additional strains on our liquidity. The note for \$170,000 contained provisions for a one-time penalty of \$25,000 if this registration statement is not filed within 120 days of August 31, 2008 and \$5,000 per 30 day period, after February 27, 2009, until the registration statement is declared effective by the SEC. The total accrued interest and penalty in the amount of \$86,454 was converted into 315,351 shares of stock and the \$170,000 principal balance was converted into 620,095 shares of common stock as of October 19, 2009. In addition, beginning March 2009 the Company was obligated to issue additional shares to the investors who purchased units in October 2008 financing equal to 2% of the units sold for each month until the registration is declared effective. The Company is obligated to issue 710,248 shares as a result of an effective registration on October 19, 2009.

Principal payments required during the years 2010 to 2014 are:

|        |            |
|--------|------------|
| 2010 - | \$ 273,620 |
| 2011 - | \$ 60,981  |
| 2012 - | \$ 100,000 |
| 2013 - | \$ 0       |
| 2014   | \$ 0       |

## NOTE 9 – RENT OBLIGATION

The Company leases its principal office under a non-cancelable lease that extends 5 years. In addition to rent the Company also pays real estate taxes, repairs and maintenance on the leased property. Rent expense, including taxes, utilities and maintenance was \$11,928 and \$7,705 in the three months ended March 31, 2010 and 2009, respectively.

The Company’s rent obligation for the years 2010 to 2013 is as follows:

|      |           |
|------|-----------|
| 2010 | \$ 29,000 |
| 2011 | 30,000    |
| 2012 | 30,000    |
| 2013 | 26,000    |

## NOTE 10 – LIABILITY FOR EQUITY-LINKED FINANCIAL INSTRUMENTS

The Company adopted ASC 815- *Derivatives and Hedging* (“ASC 815”) on January 1, 2009. ASC 815 mandates a two-step process for evaluating whether an equity-linked financial instrument or embedded feature is indexed to the entity's own stock. It is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, which was our first quarter of 2009. Most of the warrants issued by the Company contain a strike price adjustment feature, which upon adoption of ASC 815, changed the classification (from equity to liability) and the related accounting for warrants with a \$479,910 estimated fair value of as of January 1, 2009. An adjustment was made to remove \$486,564 from paid-in capital (the cumulative values of the warrants on their grant dates), a positive adjustment of \$6,654 was made to accumulated deficit, representing the gain on valuation from the grant date to January 1, 2009, and booked \$479,910 as a liability.

The January 1, 2009 valuation was computed using the Black-Scholes valuation model based upon a 2.5 year expected term, an expected volatility of 63%, an exercise price of \$.46 per share, a stock price of \$.35, a zero dividend rate and a 1.37% risk free interest rate. Subsequent to January 1, 2009 these warrants were revalued at the end of each quarter and a gain or loss was recorded based upon their increase or decrease in value during the quarter. Likewise, new warrants that were issued during 2009 and 2010 were valued, using the Black-Scholes valuation model on their date of grant and an entry was made to reduce paid-in capital and increase the liability for equity-linked financial instruments. These warrants were also re-valued at the end of each quarter based upon their expected life, the stock price, the exercise price, assumed dividend rate, expected volatility and risk free interest rate.

The inputs to the Black-Scholes model during 2009 and 2010 were as follows:

|                         |                    |
|-------------------------|--------------------|
| Stock price             | \$.35 to \$.50     |
| Exercise price          | \$.46 to \$.65     |
| Expected life           | 2.00 to 3.00 years |
| Expected volatility     | 63% to 66%         |
| Assumed dividend rate   | -%                 |
| Risk free interest rate | .895% to 1.375%    |

The original valuations, annual gain/(loss) and end of year valuations are shown below:

|  | Initial Value | Annual Gain (Loss) | Value at 12/31/2009 | 1 <sup>st</sup> Quarter Gain (Loss) | Value at March 31, 2010 |
|--|---------------|--------------------|---------------------|-------------------------------------|-------------------------|
| January 1, 2009 Adoption                   | \$ 479,910    | \$ (390,368)       | \$ 870,278          | 57,547                              | 812,730                 |
| Warrants issued in quarter ended 6/30/09   | 169,854       | 20,847             | 149,007             | 41,730                              | 107,277                 |
| Warrants issued in quarter ended 9/30/09   | 39,743        | (738)              | 40,481              | 12,371                              | 28,110                  |
| Warrants issued in quarter ended 12/31/09  | 12,698        | 617                | 12,081              | 362                                 | 11,319                  |
| Total                                      | \$ 702,205    | \$ (369,642)       | \$ 1,071,847        |                                     |                         |
| Warrants issued in quarter ended 3/31/2010 | 25,553        |                    |                     | 138                                 | 25,414                  |
| Total                                      |               |                    | \$ 1,071,847        | \$ 112,549                          | \$ 984,851              |

## NOTE 11 - RELATED PARTY

The Company entered into agreements, in 2008, with our Chairman of the Board Lawrence Gadbow, and in 2009 with board member, Peter Morawetz, to pay Mr. Gadbow \$25,000 and Mr. Morawetz \$30,000 upon the Company raising \$3 million in new equity. Mr. Gadbow will also be paid the balance, if any, due under his separation agreement from 2008. This amount was \$46,000 upon signing the agreement in 2008, is payable at \$2,000 per month, and \$10,000 remains in accounts payable as of March 31, 2010. Mr. Morawetz will also receive a stock option for 75,000 shares at \$.35 per share and Mr. Gadbow will receive a stock option for 160,000 shares at \$.35 per share upon the Company raising \$3 million.

## ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

### Overview

Our Company was incorporated in Minnesota in April 2002. We are an early-stage development company developing an environmentally conscientious system for the collection and disposal of infectious fluids that result from surgical procedures and post-operative care. We achieved our first sale in June 2009. Since our inception in 2002, we have invested significant resources into product development and in preparing for approval from the FDA. We believe that our success depends upon converting the traditional process of collecting and disposing of infectious fluids from the operating rooms of medical facilities to our wall-hung Fluid Management System (“FMS”) and use of our proprietary cleaning fluid.

Since inception, we have been unprofitable. We incurred a net loss of approximately \$752,000 for the three months ended March 31, 2010 compared to approximately \$1,005,000 for the three months ended March 31, 2009. As of March 31, 2010, we had an accumulated deficit of approximately \$6,781,000. As a company in the early stage of development, our limited history of operations makes prediction of future operating results difficult. We believe that period to period comparisons of our operating results should not be relied on as predictive of our future results.

We are an early-stage development stage company and we have been focused on finalizing our production and obtaining final FDA clearance to sell our product to the medical facilities market. FDA final clearance was obtained on April 1, 2009. Our FMS will be sold through independent medical distributors and manufacturers representatives that are intended to enhance acceptability in the marketplace. We are currently in the process of signing agreements with independent sales representatives and product installation organizations and conducting training sessions. We achieved our first billable shipment in June 2009 and are hopeful to receive several orders during 2010. Since FDA clearance was only received on April 1, 2009, and because we have been operating with insufficient working capital to build and ship products to fulfill existing orders, it is too early to know with a high degree of confidence how quickly, and in what amounts, new orders will develop.

Since we do not expect to generate sufficient revenues in 2010 to fund our capital requirements, our capital needs for the next 12 months are expected to be approximately \$3 million even though we plan to use outside third party contract manufacturers to produce the FMS and independent sales representatives to sell the FMS. Our future cash requirements and the adequacy of available funds will depend on our ability to sell our FMS and related products now that FDA final clearance has been obtained. We expect that we will require additional funding to finance operating expenses and to enter the international marketplace.

As of March 31, 2010, we have funded our operations through a bank loan of \$41,400, an equity investment of \$68,000 from the Wisconsin Rural Enterprise Fund (“WREF”) and \$30,000 in early equity investment from several individuals. WREF had also previously held debt in the form of three loans of \$18,000, \$12,500 and \$25,000. In December 2006, WREF converted two of the loans totaling \$37,500 into 43,000 shares of common stock. In August 2006, we secured a \$10,000 convertible loan from one of our vendors. In February 2007, we obtained \$4,000 in officer and director loans and in March 2007, we arranged a \$100,000 convertible note from two private investors. In July 2007, we obtained a convertible bridge loan of \$170,000. In June 2008, we paid off the remaining \$18,000 loan from WREF and have raised approximately \$1.6 million through our October 2008 financing. During 2009, we raised an additional \$625,000 in a private placement of 1,200,000 stock Units at \$.50 per Unit, which Units included one share of stock and a warrant to purchase one share of stock at \$.65 per share; and, \$100,000 in convertible debt convertible into common stock at \$.50 per share and a warrant to purchase 200,000 shares at \$.65 per share. In the first quarter of 2010, the Company raised \$87,275 in common equity by issuing 174,550 stock Units at \$.50 per Unit, which Units included one share of common stock and a warrant to purchase one share of common stock at \$.65 per share. We also borrowed \$200,000 from certain investors. The notes bear interest at 8% and are convertible into common stock of the Company at 50% of the weighted average trading price of the Company’s stock over a ten-day trading period.

## **Critical Accounting Policies and Estimates and Recent Accounting Developments**

### **Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations are based upon our audited Financial Statements, which have been prepared in accordance with U.S. Generally Accepted Accounting Principles (“GAAP”). The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of our financial statements, the reported amounts of revenues and expenses during the reporting periods presented, as well as our disclosures of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates and assumptions, including, but not limited to, fair value of stock-based compensation, fair value of acquired intangible assets and goodwill, useful lives of intangible assets and property and equipment, income taxes, and contingencies and litigation.

We base our estimates and assumptions on our historical experience and on various other information available to us at the time that these estimates and assumptions are made. We believe that these estimates and assumptions are reasonable under the circumstances and form the basis for our making judgments about the carrying values of our assets and liabilities that are not readily apparent from other sources. Actual results and outcomes could differ from our estimates.

Our significant accounting policies are described in Note 1 *Summary of Significant Accounting Policies*, in Notes to Financial Statements of this Form 10-Q. We believe that the following discussion addresses our critical accounting policies and reflect those areas that require more significant judgments, and use of estimates and assumptions in the preparation of our Financial Statements.

**Revenue Recognition.** We recognize revenue in accordance with the SEC’s Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements*, as amended by Staff Accounting Bulletin No. 104 (together, SAB 101), and Statement of Financial Accounting Standards No. 48, *Revenue Recognition When Right of Return Exists* (SFAS 48).

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed and determinable and collectability is probable. Delivery is considered to have occurred upon either shipment of the product or arrival at its destination based on the shipping terms of the transaction. Our standard terms specify that shipment is FOB BioDrain and we will, therefore recognize revenue upon shipment in most cases. This revenue recognition policy applies to shipments of our FMS units as well as shipments of cleaning solution kits. When these conditions are satisfied, we recognize gross product revenue, which is the price we charge generally to our customers for a particular product. Under our standard terms and conditions there is no provision for installation or acceptance of the product to take place prior to the obligation of the customer. The customer’s right of return is limited only to our standard warranty whereby we replace or repair, at our option, and it would be very rare that the unit or significant quantities of cleaning solution kits may be returned. Additionally, since we buy both the FMS units and cleaning solution kits from “turnkey” suppliers we would have the right to replacements from the suppliers if this situation should occur.

**Stock-Based Compensation.** Effective January 1, 2006, we adopted SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)) which replaced SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123) and superseded Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) now codified into FASB ASC 718, *Compensation-Stock Compensation* (“ASC 718”). Under ASC 718, stock-based employee compensation cost is recognized using the fair value based method for all new awards granted after January 1, 2006 and unvested awards outstanding at January 1, 2006. Compensation costs for unvested stock options and non-vested awards that were outstanding at January 1, 2006, are being recognized over the requisite service period based on the grant-date fair value of those options and awards as previously calculated under SFAS 123 for pro forma disclosures, using a straight-line method. We elected the modified-prospective method in adopting SFAS 123(R), under which prior periods are not retroactively restated.

ASC 718 requires companies to estimate the fair value of stock-based payment awards on the date of grant using an option-pricing model. We use the Black-Scholes-Merton option-pricing model which requires the input of significant assumptions including an estimate of the average period of time employees and directors will retain vested stock options before exercising them, the estimated volatility of our common stock price over the expected term, the number of options that will ultimately be forfeited before completing vesting requirements and the risk-free interest rate.

Because we have limited historical trading data on our stock we relied upon trading data from a composite of 10 medical companies traded on major exchanges and 15 medical companies traded on the Over-the-Counter Bulletin Board (“OTCBB”) to help us arrive at expectations as to volatility of our own common stock. Likewise, we have limited history of option and warrant exercises because there was no liquidity in our stock as a private company and we were required to make a significant judgment as to expected option and warrant exercise patterns in the future regarding employee and director options and warrants. In the case of options and warrants issued to consultants and investors we used the legal term of the option/warrant as the estimated term unless there was a compelling reason to use a shorter term. The measurement date for employee and non-employee options and warrants is the grant date of the option or warrant. The vesting period for options that contain service conditions is based upon management’s best estimate as to when the applicable service condition will be achieved. Changes in the assumptions can materially affect the estimate of fair value of stock-based compensation and, consequently, the related expense recognized. The assumptions we use in calculating the fair value of stock-based payment awards represent our best estimates, which involve inherent uncertainties and the application of management’s judgment. As a result, if factors change and we use different assumptions, our equity-based compensation expense could be materially different in the future. See Note 3, *Stock-Based Compensation*, in Notes to Financial Statements, for additional information.

When an option or warrant is granted in place of cash compensation for services we deem the value of the service rendered to be the value of the option or warrant. In most cases, however, an option or warrant is granted in addition to other forms of compensation and its separate value is difficult to determine without utilizing an option pricing model. For that reason we also use the Black-Scholes-Merton option-pricing model to value options and warrants granted to non-employees, which requires the input of significant assumptions including an estimate of the average period that investors or consultants will retain vested stock options and warrants before exercising them, the estimated volatility of our common stock price over the expected term, the number of options and warrants that will ultimately be forfeited before completing vesting requirements and the risk-free interest rate. Changes in the assumptions can materially affect the estimate of fair value of stock-based compensation and, consequently, the related expense recognized. Since we have limited trading history in our common stock and minimal experience with how these investors and consultants have acted in similar circumstances, the assumptions we use in calculating the fair value of stock-based payment awards represent our best estimates, which involve inherent uncertainties and the application of management’s judgment. As a result, if factors change and we use different assumptions, our equity-based consulting and interest expense could be materially different in the future.

Since our common stock has limited public trading history, we were required to take an alternative approach to estimating future volatility and the future results could vary significantly from our estimates. We compiled historical volatilities over a period of 2-7 years of 15 small-cap medical companies traded on major exchanges and 10 medical companies in the middle of the market cap size range on the OTCBB and combined the results using a weighted average approach. In the case of standard options to employees, we determined the expected life to be the midpoint between the vesting term and the legal term. In the case of options or warrants granted to non-employees, we estimated the life to be the legal term unless there was a compelling reason to make it shorter.

**Valuation of Intangible Assets.** We review identifiable intangible assets for impairment in accordance with ASC 360-*Property, Plant and Equipment* (“ASC 360”), whenever events or changes in circumstances indicate the carrying amount may not be recoverable. Our intangible assets are currently solely the costs of obtaining trademarks and patents. Events or changes in circumstances that indicate the carrying amount may not be recoverable include, but are not limited to, a significant change in the medical device marketplace and a significant adverse change in the business climate in which we operate. If such events or changes in circumstances are present, the undiscounted cash flows method is used to determine whether the intangible asset is impaired. Cash flows would include the estimated terminal value of the asset and exclude any interest charges. If the carrying value of the asset exceeds the undiscounted cash flows over the estimated remaining life of the asset, the asset is considered impaired, and the impairment is measured by reducing the carrying value of the asset to its fair value using the discounted cash flows method. The discount rate utilized is based on management’s best estimate of the related risks and return at the time the impairment assessment is made.

Our accounting estimates and assumptions bear various risks of change, including the length of the current recession facing the United States, the expansion of the slowdown in consumer spending in the U.S. medical markets despite the early expressed opinions of financial experts that the medical market would not be as affected as other markets and failure to gain acceptance in the medical market.

## Recent Accounting Developments

In June 2009, the FASB issued SFAS No. 168, “*The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*,” which is incorporated in FASB Accounting Standards Codification (ASC). Topic 105, *Generally Accepted Accounting Principles*, identifies the ASC as the authoritative source of generally accepted accounting principles in the United States. Rules and interpretive releases of the SEC under federal securities laws are also sources of authoritative GAAP for SEC registrants. This standard is effective for financial statements issued for reporting periods that end after September 15, 2009. The Company adopted SFAS No. 168 during the quarter ended June 30, 2009.

Effective June 30, 2009, the Company adopted Financial Accounting Standards Board Accounting Standards Codification (ASC) Topic 855, “*Subsequent Events*.” ASC Topic 855 addresses the types and timing of events that should be reported in the financial statements for events occurring between the balance sheet date and the date the financial statements are issued or available to be issued. The Company reviewed subsequent events for inclusion in the financial statements through the filing date of this Report on Form 10-Q. The adoption of the ASC Topic did not affect the Company’s financial position or results of operations.

## Results of Operations

### Three months ended March 31, 2010 and 2009

*Revenue.* The Company recorded \$288 in revenue in the three months ended March 31, 2010 and no revenue during the three months ended March 31, 2009. The Company received its first order for four FMS units and a case of cleaning solution kits from a hospital in Texas and shipped the first FMS unit and the cleaning solution kits in June 2009. The revenue was approximately \$14,000 for the FMS unit, approximately \$1,000 for the cleaning solution kits and \$750 for installation. The revenue in the first quarter of 2010 was for disposable supplies purchased by a beta site customer. The Company expects the revenue for FMS units to increase significantly at such time as we obtain sufficient financing to pay our contract manufacturer to produce and ship the product.

*Cost of sales.* Cost of sales was \$140 in the three months ended March 31, 2010 and \$0 in the three months ended March 31, 2009. The gross profit margin was approximately 50% for the cleaning solution kits in the three months ended March 31, 2010 but should increase over time as volume purchasing discounts on both the equipment and the cleaning solution begin to take effect.

*General and Administrative expense.* General and administrative expense primarily consists of, management salaries, professional fees, consulting fees, travel expense, administrative fees and general office expenses.

General and Administrative (G&A) expenses increased to \$712,000 in the three months ended March 31, 2010 from \$267,000 in the three months ended March 31, 2009. The increase in the three months ended March 31, 2010 was primarily due to a \$527,000 increase in stock-based consulting expense for stock and warrants issued to five consultants who were engaged to raise new funds and to increase public awareness in our stock through an investor relations program. Total G&A expenses are expected to increase due to increased insurance premiums, investor relations expenses and audit fees, resulting from becoming a public company, but otherwise remain relatively constant over the next several quarters.

*Operations expense.* Operations expense primarily consists of expenses related to product development and prototyping and testing in the Company’s current stage.

Operations expense decreased to \$65,000 in the three months ended March 31, 2010 from \$124,000 in the three months ended March 31, 2009. The decrease was primarily due to a \$70,000 reduction in consulting and testing expenses as a result of the Company obtaining FDA clearance in April 2009. Operations expense in the next several quarters is expected to increase significantly as the Company expects to commence shipments of FMS units as soon as we obtain sufficient financing to pay our contract manufacturer to build and ship the units.

*Sales and Marketing expense.* Sales and marketing expense consists of expenses required to sell products through independent representatives, attendance at trades shows, product literature and other sales and marketing activities.

Sales and marketing expenses decreased to \$73,000 in the three months ended March 31, 2010 from \$103,000 in the three months ended March 31, 2009. The decrease in expense was primarily related to a \$16,000 reduction in marketing supplies expense and a \$14,000 reduction in trade show expense. During fiscal 2009 and the first quarter of fiscal 2010, the Company has operated on a minimal marketing budget as a result of limited funding but we expect to increase our trade show, promotion and travel expense significantly after we received significant funding.

*Interest expense.* Interest expense was relatively unchanged in the three months ended March 31, 2010 compared to the three months ended March 31, 2009. The (Gain)/Loss on revaluation of equity-linked financial instruments, however, represented a gain of \$113,000 in the three months ended March 31, 2010 compared to a loss of \$497,000 in the three months ended March 31, 2009. The gain in the current period resulted from a slight reduction in the risk free interest rate used in the valuation model as well as a reduction in the remaining life and a stable underlying stock price.

## Liquidity and Capital Resources

We had a cash balance of \$40,612 as of March 31, 2010 and \$16,632 as of December 31, 2009. Since our inception, we have incurred significant losses. As of March 31, 2010 we had an accumulated deficit of \$6,781,000. We have not achieved profitability and anticipate that we will continue to incur net losses for the foreseeable future. We expect that our operations expense, including product development expense, sales and marketing and general and administrative expenses will increase, and as a result we will need to generate significant revenue to achieve profitability.

There is no certainty that access to needed capital will be successful. We have not depended on the future exercise of outstanding warrants to provide additional funding.

To date, our operations have been funded through a bank loan in the original amount of \$41,400, private party loans totaling \$10,000, convertible debt in the amounts of \$170,000 and \$400,000 and equity investments totaling approximately \$2,400,000. As of March 31, 2010 we had accounts payable of \$808,000 and accrued liabilities of \$210,000.

### Three months ended March 31, 2010 and 2009

Net cash used in operating activities was \$295,000 in the three months ended March 31, 2010 compared to \$336,000 net cash used in operating activities in the three months ended March 31, 2009. Although the net loss in the first quarter of fiscal 2010 was approximately \$250,000 less than in the first quarter of fiscal 2009, the fiscal 2009 period included a non-cash loss of \$497,000 on the valuation of equity-linked securities which offset, in part, the use of cash from operations resulting from the net loss.

Net cash used in investing activities was \$0 in the three months ended March 31, 2010 and 2009, respectively. There has been no investing activities since the Company invested in new furniture and patents in 2008. The Company will likely increase its cash used in investing activities in the next several quarters as we prepare to support the expected growth in sales.

Net cash provided by financing activities was \$319,000 in the three months ended March 31, 2010 compared to a net use of \$3,000 in the three months ended March 31, 2009. The Company expects to show additional cash provided by financing activities in fiscal 2010.

Based on our current operating plan we believe that we have sufficient cash, cash equivalents and short-term investment balances through approximately the end of the second quarter of fiscal 2010, after which an additional financing of \$2 million is anticipated. While holders of our warrants could exercise and provide cash to us during that period, we are not depending on that in our fundraising efforts.

Management hired an investment banker, in January 2010, to commence an effort to raise an additional \$3-\$5 million in new equity with an interim closing by May 31, 2010. Although our ability to raise this new capital is in substantial doubt, we received \$725,000 during 2009 and \$288,000 in the first quarter of 2010 in a Company-managed private placement of securities and convertible debt, and we believe our 510(k) clearance from the FDA in April 2009 is a positive development for the Company and will improve our ability to fundraise. If the Company is successful in raising at least \$3 million in new equity, we will have sufficient capital to operate our business and execute our business plan for at least the next 12 months. If the Company raises the additional capital by issuing additional equity securities its shareholders could experience substantial dilution.

The funds remaining from our October 2008 offering have allowed us to complete the testing and certification of our FMS unit and to receive, on April 1, 2009, final FDA clearance. We believe that our existing funds will also be sufficient to pay for normal operating expenses as we await additional funding. We have doubts about raising capital because of our early stage position and history of losses. We also believe the recent economic downturn has negatively impacted the equity markets and may impact our future fundraising efforts.

We believe that we have sufficient funds to satisfy our obligations through the second quarter of 2010. We will need additional funds to continue to satisfy such obligations beyond that time period.

Our operating plan assumes that we will achieve certain levels of operating costs and expenses, as to which there can be no assurance that we will be able to achieve. This plan is dependent on our ability to raise additional capital through future financings. In addition, if events or circumstances occur such that we are unable to meet our operating plan as expected, we will be required to seek additional capital, pursue other strategic opportunities, or we will be forced to reduce the level of expenditures, which could have a material adverse effect on our ability to achieve our intended business objectives and to continue as a going concern. Even if we achieve our operating plan, we will be required to seek additional financing or strategic investments.

We cannot assure you that our Company will be positively received by potential investors. We are not planning on any significant capital or equipment investments, and we will only have a few human resource additions over the next 12 months. A significant amount of funds will be utilized to launch our product into the market. With the expenses associated with FDA clearance having already been incurred, and with the product development primarily complete, future funds, if any, will be used primarily to launch our product into the market.

There can be no assurance that any additional financing will be available on acceptable terms, or at all. Furthermore, any equity financing likely will result in dilution to existing shareholders and any debt financing likely will include restrictive covenants.

We expect to continue to depend upon outside financing to sustain our operations for at least the next 12 months. Our ability to arrange financing from third parties will depend upon our operating performance and market conditions. Our inability to raise additional working capital at all or to raise it in a timely manner would negatively impact our ability to fund our operations, to generate revenues, and to otherwise execute our business plan, leading to the reduction or suspension of our operations and ultimately forcing us to go out of business. Should this occur, the value of any investment in our securities could be adversely affected, and an investor could lose a portion of or all of their investment.

### **Inflation**

We do not believe that inflation has had a material impact on our business and operating results during the periods presented.

### **Off-Balance Sheet Arrangements**

We have not engaged in any off-balance sheet activities as defined in Item 303(a)(4) of Regulation S-K.

### **Information Regarding Forward-Looking Statements**

This Form 10-K contains “forward-looking statements” that indicate certain risks and uncertainties related to the Company, many of which are beyond the Company’s control. The Company’s actual results could differ materially and adversely from those anticipated in such forward-looking statements as a result of certain factors, including those set forth below and elsewhere in this report. Important factors that may cause actual results to differ from projections include:

- Adverse economic conditions;
- Inability to raise sufficient additional capital to operate our business;
- Unexpected costs and operating deficits, and lower than expected sales and revenues, if any;
- Adverse results of any legal proceedings;
- The volatility of our operating results and financial condition;
- Inability to attract or retain qualified senior management personnel, including sales and marketing personnel; and
- Other specific risks that may be alluded to in this report.

All statements, other than statements of historical facts, included in this report regarding the Company’s growth strategy, future operations, financial position, estimated revenue or losses, projected costs, prospects and plans and objectives of management are forward-looking statements. When used in this report, the words “will,” “may,” “believe,” “anticipate,” “intend,” “estimate,” “expect,” “project,” “plan” and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain such identifying words. All forward-looking statements speak only as of the date of this report. The Company does not undertake any obligation to update any forward-looking statements or other information contained herein. Potential investors should not place undue reliance on these forward-looking statements. Although the Company believes that its plans, intentions and expectations reflected in or suggested by the forward-looking statements in this report are reasonable, the Company cannot assure potential investors that these plans, intentions or expectations will be achieved. The Company discloses important factors that could cause the Company’s actual results to differ materially from its expectations in the “Risk Factors” section of the Post-Effective Amendment No. 1 to our Registration Statement on Form S-1 filed with Securities and Exchange Commission on May 5, 2010 and elsewhere in this report. These cautionary statements qualify all forward-looking statements attributable to the Company or persons acting on its behalf.

### **ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

Not required.

### **ITEM 4T. Controls and Procedures**

#### *Disclosure Controls*

Our management, including our President, Chief Executive Officer and Chief Financial Officer (referred to as the “Certifying Officer”), evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act as of the end of the period covered by this Report on Form 10-Q. Based on that evaluation, the Certifying Officer concluded that, as of the end of the period covered by this quarterly report, our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) are effective, in all material respects, to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our President, Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

#### *Changes in Internal Controls*

There were no changes in our internal controls over financial reporting during the first quarter of fiscal year 2010 that may have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. Legal Proceedings**

In April 2009, Gerald Rice, a former officer of the Company, made a demand for payment of past wages and threatened to sue the Company for in excess of \$100,000 if we did not meet his demand. Settlement discussions commenced but the parties were unable to reach an agreement. Thereafter, Mr. Rice filed a lawsuit in Minnesota state court, Dakota County, alleging claims for breach of contract and stating claims for unpaid wages. The Company answered the complaint and denied the allegations therein. The Company believes that the claims are without merit and will continue to defend the claims. We are not a party to any other pending legal proceedings that, if decided adversely to us, would have a material adverse effect upon our business, results of operations or financial condition and are not aware of any threatened or contemplated proceeding by any governmental authority against our company. To our knowledge, we are not a party to any pending civil or criminal action or investigation.

### **ITEM 1A. Risk Factors**

Not required.

### **ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

In January 2010, the Company borrowed \$200,000 from certain investors, including one member of the Company's Board of Directors. The notes bear interest at 8% and are convertible into common stock of the Company, at the election of the holder, at a conversion rate equal to 50% of the weighted average trading price of the Company's stock over a ten-day trading period.

In January 2010, the Company issued 19,090 restricted shares of common stock under the 2008 Equity Incentive Plan to a consultant as partial payment for his services.

In January 2010 the Company issued Warrants to purchase 800,000 shares at \$.10 per share to two consultants in return for investor relations services.

In March 2010, the Company issued 350,000 shares of common stock as payment to three consultants for their investor relations consulting services.

In March and April 2010, the Company issued 274,550 shares of common stock and warrants for 274,550 shares of common stock, at an exercise price of \$.65 per share, to nine investors for their \$137,275 investment in the Company.

Unless otherwise specified above, the Company believes that all of the above transactions were transactions not involving any public offering within the meaning of Section 4(2) of the Securities Act, since (a) each of the transactions involved the offering of such securities to a substantially limited number of persons; (b) each person took the securities as an investment for his/her/its own account and not with a view to distribution; (c) each person had access to information equivalent to that which would be included in a registration statement on the applicable form under the Securities Act; and (d) each person had knowledge and experience in business and financial matters to understand the merits and risk of the investment; therefore no registration statement needed to be in effect prior to such issuances.

### **ITEM 3. Defaults Upon Senior Securities**

None.

### **ITEM 4. Submission of Matters to a Vote of Security Holders**

None.

### **ITEM 5. Other Information**

None.

### **ITEM 6. Exhibits**

See the attached exhibit index.



## SIGNATURES

Pursuant to the requirements 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.

Date: May 17, 2010

**BIODRAIN MEDICAL, INC.**

By: /s/ Kevin R. Davidson

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Kevin R. Davidson  
President, Chief Executive Officer and Chief Financial  
Officer  
(Principal Executive Officer and Principal Financial  
Officer)

**EXHIBIT INDEX**  
**BIODRAIN MEDICAL, INC.**  
**FORM 10-Q**

| Exhibit<br>No. | Description   |
|----------------|---|
| 31.1*          | Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1*          | Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

\* Filed herewith.