GUIDED THERAPEUTICS INC
Form 10-K/A
September 23, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K /A1

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________ to ____________

Commission file number: 0-22179

GUIDED THERAPEUTICS, INC.

(Exact name of registrant as specified in its charter)

Delaware	58-2029543
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4955 Avalon Ridge Parkway, Suite 300 Norcross, Georgia	30071
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number (including area code): (770) 242-8723

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Act: Common Stock, $0.001 par value

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes [ ] No [X]

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 [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.
Large accelerated filer [ ]
Accelerated filer [ ]
Non-accelerated filer [ ]
Smaller reporting company [X]

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

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant was approximately $5,334,151 as of June 29, 2007 (the last business day of the registrant's most recently completed second fiscal quarter), based upon the closing sales price of the registrant's Common Stock of $0.40, reported for such date by the OTC Bulletin Board and 13,335,377 shares of Common Stock outstanding as of June 29, 2007.

As of June 20, 2008, the registrant had outstanding 13,353,896 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

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None.

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Explanatory Note

The Company is filing this amendment No. 1 to its annual report on Form 10-K for the year ended December 31, 2007 to (i) make certain modifications, including clerical changes, to Part II, Items 7, 8 and 9A in response to comments received from the SEC. Except for the foregoing amended information, this Form 10-K/A1 continues to describe conditions as of the date of the original filing, and the disclosures contained in this Form 10-K/A1 have not been updated to reflect events, results or developments that occurred at a later date. Among other things, forward-looking statements made in the original filing have not been revised to reflect events, results or developments that occurred or facts that became known to us after the date of the original filing, and such forward-looking statements should be read in their historical context. In addition, as further required by Rule 12b-15, this Form 10-K/A1 contains new certifications by our principal executive officer and our principal financial officer, filed as exhibits hereto under Part IV, Item 15 hereof.

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PART II

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Words such as "may," "should," "could," "would," "predicts," "potential," "continue," "expects," "anticipates," "future," "intends," "plans," "believes," "estimates" and similar expressions, as well as statements in future tense, identify forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, such performance or results will be achieved.

The following discussion should be read in conjunction with our financial statements and notes thereto included elsewhere in this report.

Overview

We were incorporated on October 27, 1992 under the name of SpectRx, Inc., The company name was changed to Guided Therapeutics, Inc. in December of 2007. Since the company's inception, we have raised capital through the sale of preferred stock, issuance of debt securities, public and private sales of common stock, funding from collaborative arrangements and sales of assets. Following our initial funding in early 1993, we immediately began research and development activities with the objective of commercializing less invasive diagnostic, screening and monitoring products. We commercialized the Bili*Chek* in 1998, which we later sold to Respironics, Inc. in 2003. We attempted to commercialize a diabetes screening instrument with Roche, and a glucose monitoring product with Abbott. We also conducted a joint venture with Welch Allyn, Inc. related to our cervical cancer detection technology from 1999 to 2002.

In December 2001, we acquired 100% of the common stock of Sterling, a company formed for the purpose of developing and marketing insulin-delivery products, which we sold in May of 2007.

We have a limited operating history upon which our prospects can be evaluated. Our prospects must be considered in light of the substantial risks, expenses and difficulties encountered by entrants into the medical device industry. This industry is characterized by an increasing number of participants, intense competition and a high failure rate. We have experienced operating losses since our inception, and, as of December 31, 2007, we have an accumulated deficit of about $64.6 million. To date, we have engaged primarily in research and development efforts. We first generated revenues from product sales in 1998, but do not have significant experience in manufacturing, marketing or selling our products. Our development efforts may not result in commercially viable products and we may not be successful in introducing our products. Moreover, required regulatory clearances or approvals may not be obtained in a timely manner, or at all. Our products may not ever gain market acceptance and we may not ever generate significant revenues or achieve profitability. The development and commercialization of our products will require substantial development, regulatory, sales and marketing, manufacturing and other expenditures. We expect our operating losses to continue through at least the end of 2009 as we continue to expend substantial resources to introduce our cervical cancer detection product, further the development of our other products, obtain regulatory clearances or approvals, build our marketing, sales, manufacturing and finance organizations and conduct further research and development.

Our product revenues to date have been limited. For 2006 and 2007, a majority of our revenues came from our SimpleChoice insulin delivery product and National Institute of Alcohol Abuse and Alcoholism ("NIAAA") research contract revenue. We expect that the majority of our revenue in 2008 will be derived from research contract revenue. Our other products for glucose monitoring and cervical cancer detection are still in development.

As a result of the sale of our SimpleChoice business to ICU Medical in May of 2007, we no longer obtain revenues from sales of SimpleChoice products to distributors. Such revenues were approximately $375,000 and $66,000 for the years ended December 31, 2006 and 2007, respectively. For the year ended December 31, 2007, revenue had declined significantly, since the Company had reduced operations, significantly, in anticipation of the sale. The channels for sales of our glucose monitoring and cervical cancer detection products are not currently established. As a result of supply issues and a distribution issues prior to the sale of our SimpleChoice business, our insulin delivery product sales decreased significantly in 2007.

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Recent Developments

On May 9, 2007, we and Sterling sold to ICU Medical, Inc., or ICU, substantially all of our assets related to our SimpleChoice business. The purchase price for the sale of these assets was $3,000,000, and after adjustment for certain escrow amounts and escrow fees, we received approximately $2.7 million. Under the terms of the sale, we may receive certain additional payments from ICU, not to exceed $1,000,000 in any calendar year, relating to sales of products covered by a certain patent entitled "Infusion Hub Assembly and Fluid Line Disconnect System." Additionally, ICU granted us a license to make, use, or sell products covered by a certain patent relating to "Insertion

Device for an Insertion Set and Method of Using the Same" and we agreed to make certain royalty payments to ICU, not to exceed $1,000,000 in any calendar year, on sales of products covered by this patent. In connection with the sale, we announced the termination of any further sales of SimpleChoice products and we are currently focused on completing the development of our cervical cancer detection device.

On November 9, 2007, we entered into an agreement with the MacKay Group, Ltd. ("MacKay") to manufacture and supply non-invasive breast and cervical cancer detection products for the Asian market. Under terms of the agreement, we will manufacture for MacKay a specified number of Biofield Breast Diagnostic Systems (a non-invasive breast cancer detection devise), and MacKay will purchase a specified minimum number of our LightTouch™ Non-invasive Cervical Cancer Detection Devices and associated single-patient-use disposables. We will manufacture the devices at our facility in Norcross, Georgia. The Biofield devices will be sold on a cost plus basis, the LightTouch devices and disposables will be sold on a fixed price basis.

Critical Accounting Policies

Our material accounting policies, which we believe are the most critical to an investor's understanding of our financial results and condition, are discussed below. Because we are still early in our enterprise development, the number of these policies requiring explanation is limited. As we begin to generate increased revenue from different sources, we expect that the number of applicable policies and complexity of the judgments required will increase.

Currently, our policies that could require critical management judgment are in the areas of revenue recognition, reserves for accounts receivable and inventory valuation.

Revenue Recognition:

We recognize revenue from sales of products or services upon shipment of products or when services are rendered. We also recognize milestone revenue from collaborative partners when a milestone has been accomplished or when we, and our partner, agree that a milestone has been reached. If collectibility of accounts receivable for milestones or services is doubtful, revenues and gains are recognized on the basis of cash received. We have relied upon SEC Staff Accounting Bulletin, or SAB, 101 and SAB 104 for guidance in recognizing revenue and related costs.

Service Revenues:

Service revenues are considered to have been earned when we have substantially accomplished what we must do to be entitled to the benefits represented by the service revenues. Accordingly, we record revenue from service contracts where the service is completed and the customer is invoiced in accordance with the terms of a written, duly executed service contract or purchase order.

Allowance for Accounts Receivable:

We estimate losses from the inability of our customers to make required payments and periodically review the payment history of each of our customers, as well as their financial condition, and revise our reserves as a result.

Inventory Valuation:

Inventories are valued at the lower of cost or market value and have been reduced by an allowance for excess and obsolete inventories, if necessary.

Results of Operations

Comparison of 2006 and 2007

General: Net loss attributable to common stockholders decreased to approximately $1.1 million or $0.09 per share in 2007, from $5.3 million or $0.45 per share in 2006. Net loss attributable to common stockholders for the twelve months ended December 31, 2007, included a gain from debt forgiveness of approximately $5.8 million and a gain on sale of SimpleChoice of approximately $2.1 million (net of tax), offset primarily by a deemed dividend on series A convertible preferred stock of approximately $3.8 million.

We expect net losses to continue. We sold our SimpleChoice business in May 2007 for $3 million, of which, we had a net gain on sale of $2.1 million and therefore will not have sales from this product line going forward. We are dependent upon the completion of our cervical cancer and interstitial fluid based glucose monitoring development programs and will not have significant sales until a product can be launched. If the cervical cancer product can be launched, it is possible that our product revenue will not meet our expectations. If this were to happen, future net losses could increase as a result of spending increases necessary to complete research, development and clinical trials of our products, beginning sales and marketing efforts and establishing manufacturing capabilities. This would delay some of our product development activities.

Revenue and Cost of Product Sales: Total revenues increased to $1,037,000 in 2007, from about $602,000 in 2006. There was an increase in revenue from contracts from the NIAAA, of approximately $400,000 in 2007, compared to 2006. Cost of sales decreased to approximately $52,000 in 2007, from approximately $128,000 in 2006, due to cessation of production in 2007.

Research and Development Expenses: Research and development expenses increased to approximately $1.9 million in 2007 compared to approximately $1.5 million in 2006 due an increase in expenses related to our cancer detection technology, partially offset by reimbursements from the National Cancer Institute of about $1.4 million. We expect research and development expenses to decrease in the future in the area of our glucose monitoring and to increase in the area of our cervical cancer detection program.

General and Administrative Expense: General and administrative expense increased to about $2.5 million in 2007, from about $2.0 million in 2006. The increase is primarily related to executive severance pay expense of approximately $410,000, as part of the sale of SimpleChoice, as well as certain accrued expenses. Costs of warrants issued to non-converting bridge note holders approximated $70,000 for the year ended December 31, 2007, offset in part by reduced executive compensation expenses.

Non operating gain on debt forgiveness, Other Income and Interest Expense, net: In 2007, the Company had a debt forgiveness of approximately $5.8 million, arising out of settlement of a dispute with Abbott Laboratories, Inc. (see Note 4). Other income decreased to approximately $24,000 in 2007, compared to approximately $200,000 in 2006. Interest expense increased to approximately $1.2 million for the year ended December 31, 2007, as compared to expenses of approximately $709,000 for the same period in 2006. The increase is primarily due to accretion of debt discount and a beneficial conversion feature of convertible notes payable in the amount of approximately $232,000 in 2007, and accrued penalties in connection with registration rights under an amended loan totaling approximately $91,000. Costs of warrants repriced and issued to non-converting bridge noteholders approximated $84,000 for the year 2007. Interest paid on loans increased by approximately $746,000 for the year ended December 31, 2007, as compared to the same period in 2006, primarily due to conversion of the bridge loan payable and additional borrowings.

Operations Going Forward Without SimpleChoice

Revenue will be derived from continuation of our NIAAA contract, as well as sales of porators (an ISF extraction device allowing for diagnostic tests similar to those done using blood) and services for research studies. Management expects that such revenues will average approximately $225,000 per quarter, but there can be no assurance that such revenue will be achieved. Our marketing expenses will decrease significantly until we launch our cervical cancer detection device (we have not yet established a specific date for the launching), since prior marketing expenses were directly related to SimpleChoice. Research and development costs will increase significantly, due to the cervical cancer detection device in development. General and administrative expenses will also be reduced significantly, until the cervical cancer device is launched (see Note 1 - "Going Concern" to the financial statements included in this report).

Liquidity and Capital Resources

We have financed our operations since inception primarily through private sales of debt and private and public sales of our equity securities. At December 31, 2007, we had cash of approximately $3,000 and negative working capital of approximately $3.7 million.

Our major cash flows in the year ended December 31, 2007, consisted of cash out-flows of $3.9 million from operations (including approximately $3.0 million of net income). The net income for the year ended December 31, 2007, included a gain from debt forgiveness of approximately $5.8 million and a gain on sale of SimpleChoice of approximately $2.1 million (net of tax), a net change from investing activities of $2.7million, which primarily represents the proceeds from the sale of SimpleChoice through December 31, 2007, and $1.1 million net cash provided by financing activities, due to proceeds received from our convertible notes payable.

We have historically also received funds from milestone payments and reimbursements from our collaborative partners. We are currently seeking a collaborative partner for our glucose monitoring technology. Until we reach an agreement with a new partner, we expect minimal or no such milestones or reimbursements.

On March 12, 2007, we completed a restructuring of our then-existing indebtedness by entering into an Amended and Restated Loan Agreement ("Amended Loan") with existing and new creditors. Pursuant to the Amended Loan, the existing Loans under the then-existing indebtedness were restructured and consolidated into new 13% Senior Secured Convertible Notes (the "Convertible Notes"). The aggregate principal amount of the Amended Loan is approximately $4.8 million due on March 1, 2010. No interest is due until maturity, absent an event of default under the Amended Loan. If an event of default occurs and is continuing, the interest rate on the Amended Loan becomes 18%. These notes are convertible into our common stock at $0.65 per share, or 7,285,061 shares of common stock, and were issued with approximately 7.2 million warrants, exercisable immediately at $0.78 per share for our common stock. Additionally, accrued interest on the Convertible Notes is convertible into shares of our common stock, on the same terms. In addition, 661,000 warrants at an exercise price of $0.78 were also issued to the placement agent and others in conjunction with this financing, as well as a warrant to purchase 15,000 shares of our common stock at $0.78, as part of interest expense to a non-converting bridge note holder, as interest on the notes payable. The fair value of the warrant to purchase 15,000 shares of our common stock was approximately $6,000 at March 31, 2007. This amount was expensed in our statement of operations for the period then ended. The conversion price and the exercise price of the warrants are subject to adjustments for anti-dilution.

On March 12, 2007, the relative fair value of the warrants was approximately $2.3 million (including $.3 million attributed to 661,000 warrants for placement agent treated as debt issuance cost), and the relative fair value of the beneficial conversion feature was approximately $1.3 million. The debt discount, consisting of the beneficial conversion feature and warrants, will accrete over the 36-month term of the Convertible Notes payable using the effective interest method. In addition, debt issuance costs totaling approximately $811,000 ($520,000 cash costs and $291,000 warrant value for 661,000 warrants given to placement agent and others) will also be amortized over 36 months, using the effective interest method.

The Amended Loan is our senior secured obligation and is secured by (a) a first in priority lien on all of our assets; (b) a guaranty by Sterling; (c) a lien on all of Sterling's assets (except the SimpleChoice business); and (d) a pledge on all issued and outstanding stock of Sterling and InterScan.

On April 17, 2007, the Company issued notes totaling approximately $440,827 to four officers and former officers representing unpaid salary (accrued as of December 31, 2006), pursuant to letter agreements executed in 2004 that would have become payable after the closing of the Amended Loan. The notes were in the amounts of: $188,721 to William D. Arthur, III, former President and Chief Operating Officer; $100,946 to Richard Fowler, Senior Vice President of Engineering; $86,445 to Thomas H. Muller, Jr., former Chief Financial Officer; and $64,715 to Walter Pavlicek, former Vice President of Operations. The notes were unsecured and were payable upon the sale of certain assets or at any time after August 28, 2007 when we had more than $1 million of cash on hand. Two of the notes had an interest rate of 13% and two of the notes had an interest rate of 7%, with interest accruing from March 1, 2007. These amounts could have been construed to be past due under the 2004 letter agreements. All such notes and Mark Samuels' accrued salary were paid in the second quarter of 2007.

We will be required to raise additional funds through public or private financing, additional collaborative relationships or other arrangements in addition to these sources. We believe our existing and available capital resources will be sufficient to satisfy our funding requirements through July 31, 2008, excluding any amounts due on redeemable convertible preferred stock, although we need to secure a collaborative partner to move forward with our continuous glucose program and will need additional funding to complete our pivotal trials for our cervical cancer detection product in a timely fashion. We are evaluating various options to further reduce our cash requirements to operate at a reduced rate, as well as options to raise additional funds, including loans using certain assets as collateral.

Substantial capital will be required to develop our products, including completing product testing and clinical trials, obtaining all required United States and foreign regulatory approvals and clearances, and commencing and scaling up manufacturing and marketing our products. Any failure to obtain capital would have a material adverse effect on our business, financial condition and results of operations.

Off-Balance Sheet Arrangements

We have no material off-balance sheet arrangements; no special purpose entities; nor activities that include non-exchange-traded contracts accounted for at fair value.

Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

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To the Board of Directors and Stockholders of
Guided Therapeutics, Inc. and its Subsidiaries, formerly known as SpectRx, Inc.
Atlanta, Georgia

We have audited the accompanying consolidated balance sheet of Guided Therapeutics, Inc. and subsidiaries (the "Company") as of December 31, 2007, and the related consolidated statements of operations, changes in capital deficit and cash flows for the year ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit and do not express an opinion on the consolidated balance sheet of SpectRx Inc., (now Guided Therapeutics, Inc.) and subsidiaries (the "Company") as of December 31, 2006, and the related consolidated statements of operations, changes in capital deficit and cash flows for the year ended December 31, 2006. Those financial statements were audited by another Independent Registered Public Accounting Firm, and their opinion, dated April 19, 2007, expressed an unqualified opinion on the consolidated financial statements and included explanatory paragraphs regarding the Company's adoption of Statement of Financial Accounting Standards No. 123 (revised 2004), "Share Based Payment" on January 1, 2006 and the Company's ability to continue as a going concern.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We were not engaged to examine management's assertion about the effectiveness of the Company's control over financial reporting as of December 31, 2007 included in the accompanying Management's Report on Internal Control over Financial Reporting and, accordingly, we do not express an opinion thereon.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2007, and the results of its operations, its changes in capital deficit, and its cash flows for the year ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

As described in Note 2 to the consolidated financial statements, on January 1, 2007 the Company adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes."

As described in Note 2 to the consolidated financial statements, on January 1, 2006 the Company adopted the provisions of Financial Accounting Standards No. 123 (revised 2004), "Share -Based Payment".

Also as described in Note 1 to the consolidated financial statements, the accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company's recurring losses from operations, accumulated deficit and working capital deficit raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also discussed in Note 1 to the consolidated financial statements. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ UHY LLP

Atlanta, Georgia

July 8, 2008, except for notes 14 as to which the date is September 23, 2008

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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Guided Therapeutics, Inc.

We have audited the accompanying consolidated balance sheet of Guided Therapeutics, Inc. and subsidiaries (formerly SpectRx, Inc. and subsidiaries) (the "Company") as of December 31, 2006, and the related consolidated statements of operations, changes in capital deficit and cash flows for the year ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Guided Therapeutics, Inc. and subsidiaries (formerly SpectRx, Inc. and subsidiaries) as of December 31, 2006 and the consolidated results of their operations and their consolidated cash flows for the year then ended , in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2006, the Company changed its method of accounting for stock-based compensation in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment."

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has suffered recurring losses and has a negative working capital position and a capital deficit. The Company is also in default on payments due under its settlement with Abbott Laboratories, Inc. regarding its redeemable preferred stock agreement. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also as described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Eisner LLP

New York, New York
April 19, 2007

With respect to the reclassification of Simple Choice business as discontinued operations, as described in Note 1
January 25, 2008

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GUIDED THERAPEUTICS, INC. (FORMERLY SPECTRX, INC.) AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2006 and 2007
(In Thousands Except Per Share Data)

ASSETS	(As Revised - See Note 1)	
(Notes 9 and 10)	2006	2007
CURRENT ASSETS:		
Cash and cash equivalents	$206	$3
Accounts receivable, net of allowance for doubtful accounts of $41 and $25 at December 31, 2006 and 2007, respectively	72	167

Other current assets	121	17
Assets of discontinued operations	223	-
Total current assets	622	187
Property and equipment, net	19	18
Assets of discontinued operations	549	-
Deferred debt issuance costs, net	-	721
Other assets	51	51
Total noncurrent assets	619	790
TOTAL ASSETS	$1,241	$977
LIABILITIES AND CAPITAL DEFICIT		
CURRENT LIABILITIES:		
Short term notes payable	$-	$102
Notes payable - past due	416	481
Notes payable	206	-
Notes payable - Related party	1,224	-
Accounts payable	604	786
Accrued liabilities	634	706
Redeemable convertible stock and accrued interest and dividends in default	5,566	-
Dividends payable - Series A	1,002	1,327
Advances payable - Roche	381	381
Liabilities of discontinued operations	625	-
Total current liabilities	10,658	3,783
Convertible notes payable, including accrued interest, net of debt discount of $3,142 at December 31, 2007, to former debt holders-related parties	1,924	2,123
TOTAL LIABILITIES	12,582	5,906
COMMITMENTS & CONTINGENCIES (Note 6)		
CAPITAL DEFICIT:		

Series A convertible preferred stock, $.001 par value; 5,000 shares authorized, 484 and 418 shares issued and outstanding as of 2006 and 2007, respectively (liquidation preference $8,254 and $7,579 for 2006 and 2007, respectively)	4,511	3,904
Common stock, $.001 par value; 50,000 shares authorized, 11,918 and 11,872 issued and outstanding as of 2006; 100,000 shares authorized, 13,353 and 13,400 shares issued and outstanding as of 2007	12	13
Additional paid-in capital	51,854	55,856
Treasury stock, at cost	(104)	(104)
Accumulated deficit	(67,614)	(64,598)
TOTAL CAPITAL DEFICIT	(11,341)	(4,929)
TOTAL LIABILITIES AND CAPITAL DEFICT	$1,241	$977

The accompanying notes are an integral part of these consolidated statements.

GUIDED THERAPEUTICS INC. (FORMERLY SPECTRX, INC.) AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2007
(In Thousands Except Per Share Data)

	(As Revised - See Note 1)	(As Revised - See Note 14)
	2006	2007
REVENUE:		
Service revenue	$602	$1,037
COSTS AND EXPENSES:		
Cost of sales	128	52
Research and development	1,474	1,925
Sales and marketing	12	-
General and administrative	1,967	2,462
Operating (loss) / income	(2,979)	(3,402)
NON OPERATING GAIN ON DEBT FORGIVENESS	-	5,816
OTHER INCOME	200	24

INTEREST EXPENSE, net	(709)	(1,213)
NET (LOSS) INCOME FROM CONTINUING OPERATIONS	(3,488)	1,225
PROVISION FOR INCOME TAXES	-	-
(LOSS) INCOME / FROM DISCONTINUED OPERATIONS (including gain on disposal of $2.1 million in 2007)	(1,460)	1,791
NET (LOSS) / INCOME	(4,948)	3,016
PREFERRED STOCK DIVIDENDS	(364)	(325)
DEEMED DIVIDEND ON SERIES A CONVERTIBLE PREFERRED STOCK	-	(3,811)
NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	$(5,312)	$(1,120)

BASIC AND DILUTED NET (LOSS) PER SHARE ATTRIBUTABLE TO COMMON STOCKHOLDERS, FROM CONTINUING OPERATIONS

$(0.33)

$(0.23)

BASIC AND DILUTED NET (LOSS) / INCOME PER SHARE ATTRIBUTABLE TO COMMON STOCKHOLDERS, FROM DISCONTINUED OPERATIONS

$(0.12)

$0.14

BASIC AND DILUTED NET (LOSS) PER SHARE ATTRIBUTABLE TO COMMON STOCKHOLDERS, TOTAL

$(0.45)

$(0.09)

BASIC AND DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING

11,780

12,781

The accompanying notes are an integral part of these consolidated statements.

GUIDED THERAPEUTICS INC. (FORMERLY SPECTRX, INC.) AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN CAPITAL DEFICIT
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2007
(In Thousands)

	Preferred Stock		Common Stock		Additional Paid-In	Treasury	Deferred	Accumulated	
	Shares	Amount	Shares	Amount	Capital	Stock	Compensation	Deficit	TOTAL
BALANCE, December 31, 2005	489	$4,559	11,738	$12	$52,036	$(104)	$(4)	$(62,666)	$(6,167)
Employee stock purchase	-	-	16	-	4	-	-	-	4

plan									
Options issued to employees	-	-	-	-	90	-	4	-	94
Exercise of stock options	-	-	61	-	32	-	-	-	32
Dividends on preferred stock	-	-	-	-	(364)	-	-	-	(364)
Conversion of preferred stock into common stock	(5)	(48)	57	-	56	-	-	-	8
Net Loss	-	-	-	-	-	-	-	(4,948)	(4,948)
BALANCE, December 31, 2006	484	$4,511	11,872	$12	$51,854	$(104)	$-	$(67,614)	$(11,341)
Stock issued to employees	-	-	100	-	-	-	-	-	-
Warrants issued	-	-	-	-	3,690	-	-	-	3,690
Exercise of stock options	-	-	13	-	31	-	-	-	31
Dividends on preferred stock	-	-	-	-	(325)	-	-	-	(325)
Conversion of preferred stock into common stock	(66)	(607)	1,368	1	606	-	-	-	-
Net Income	-	-	-	-	-	-	-	3,016	3,016

BALANCE, December 31, 2007	418	$3,904	13,353	$13	$55,856	$(104)	$-	$(64,598)	$(4,929)

The accompanying notes are an integral part of these consolidated statements.

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GUIDED THERAPEUTICS INC. (FORMERLY SPECTRX, INC.) AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2007
(In Thousands)

	(As Revised - See Note 1)	
	2006	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$(4,948)	$3,016
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss from discontinued operations	1,460	-
Gain on sale of discontinued operations	-	(2,086)
Gain on forgiveness of debt	-	(5,816)
Depreciation and amortization	22	9
Provision for inventory obsolescence	-	153
Amortization and accretion of deferred financing costs, notes payable and warrants	-	232
Amortization of deferred compensation	4	31

Issuance of options and warrants for services and debt	90	84
Changes in operating assets and liabilities:		
Accounts receivable	181	(56)
Other current assets	49	104
Other assets	16	31
Accounts payable	288	(139)
Accrued liabilities	474	788

Total adjustments	2,584	(6,665)
Net cash used in discontinued operations	(1,211)	(295)
Net cash used in operating activities	(3,575)	(3,944)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net proceeds from sale of SimpleChoice - Discontinued operations	-	2,689
Additions to property and equipment	(9)	(27)
Net cash used in discontinued operations	(64)	-

Net cash (used in) provided by investing activities	(73)	2,662
CASH FLOWS FROM FINANCING ACTIVITIES:		
Debt issuance costs	-	(520)
Proceeds from issuance of convertible notes payable to former debt holders-related parties	3,937	2,791
Payments of notes payable	(400)	(1,193)
Issuance of common stock	4	1
Net cash provided by financing activities	3,541	1,079
NET CHANGE IN CASH AND CASH EQUIVALENTS	(107)	(203)
CASH AND CASH EQUIVALENTS, beginning of year	313	

206

CASH AND CASH EQUIVALENTS, end of year

$206

$3

SUPPLEMENTAL SCHEDULE OF:		
Cash paid for:		
Interest	$13	$1,437
NONCASH INVESTING AND FINANCING ACTIVITIES:		
Conversion of preferred stock into common stock	$56	$979
Bridge notes payable converted into convertible notes payable	-	$1,944
Dividends in the form of preferred stock and redeemable convertible preferred stock	$364	$325
Deemed dividend on Series A convertible preferred stock	$-	$3,811
Common stock and options exercised in exchange for accrued salaries	$32	$-

The accompanying notes are an integral part of these consolidated statements.

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GUIDED THERAPEUTICS INC. (FORMERLY SPECTRX, INC.) AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2006 AND 2007

1. Organization, Background, and Basis Of Presentation

Guided Therapeutics, Inc. (formerly SpectRx, Inc.), together with its wholly owned subsidiaries, Sterling Medivations, Inc. d/b/a SimpleChoice ("Sterling") and InterScan, Inc. (formerly Guided Therapeutics, Inc.), collectively referred to herein as the "Company", is a medical technology company developing and providing products for the non-invasive cervical cancer detection and diabetes markets. The Company uses its technologies to develop non-invasive diagnostic devices such as its cervical cancer detection product and its interstitial fluid based glucose monitoring device. The Company's products are based upon a variety of proprietary technologies. The Company has products in development for glucose monitoring and cervical cancer detection that are based upon its proprietary biophotonic technologies.

Discontinued Operations

In May 2007, the Company sold all of its assets related to the field of subcutaneous fluid delivery, including certain equipment and intellectual property, to ICU Medical, Inc. for $3,000,000, and after adjustments for certain contingencies, the Company received $2,688,661. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, the Company has accounted for this asset group as a discontinued operation. The Company's consolidated financial statements reflect the assets and liabilities of the discontinued operations as separate line items and the operations of the asset group for the current and prior period are reported in discontinued operations on the statement of operations.

Assets and liabilities of the discontinued operations included in the consolidated balance sheet as of December 31, 2006 were as follows:

Accounts receivable, net	$39
Inventory	184
Assets of discontinued operations, current	223
Property and equipment, net	549
Total assets of discontinued operations	$772

Accounts payable	$321
Accrued liabilities	304
Liabilities of discontinued operations, current	$625

The following table presents the financial results of the discontinued operations:

	Year Ended December 31,	
	2006	2007
Sales	$ 375	$ 66
Cost of sales	883	229
Gross loss	(508)	(163)
Costs and expenses:		
Research and development	482	34
Sales and marketing	217	20
General and administrative	253	78
Total	952	132

costs and expenses		
Loss from discontinued operations, before disposal	$ (1,460)	$ (295)
Gain on sale of disposal, net of taxes	-	2,086
(Loss) profit from discontinued operations	$ (1,460)	$ 1,791
(Loss) profit per common share - basic and diluted:		
(Loss) profit from discontinued operations	$ (0.12)	$ 0.14

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Basis of Presentation

The audited consolidated financial statements included herein have been prepared by the Company, and reflect adjustments, all of which are of a normal, recurring nature, and which are, in the opinion of management, necessary to present fairly the Company's financial position, results of operations, and cash flows for the years ended December 31, 2006 and 2007. All information and footnote disclosures included in financial statements have been prepared in accordance with accounting principles generally accepted in the United States. Preparing financial statements requires the Company's management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

The Company's prospects must be considered in light of the substantial risks, expenses and difficulties encountered by entrants into the medical device industry. This industry is characterized by an increasing number of participants, intense competition and a high failure rate. The Company has experienced net losses since its inception and, as of December 31, 2007, it had an accumulated deficit of approximately $64.6 million. Through December 31, 2007, the Company has devoted substantial resources to research and development efforts. The Company first generated revenue from product sales in 1998, but does not have significant experience in manufacturing, marketing or selling its products. The Company's development efforts may not result in commercially viable products and it may not be successful in introducing its products. Moreover, required regulatory clearances or approvals may not be obtained. The Company's products may not ever gain market acceptance and the Company may not ever achieve levels of revenue to sustain further development costs and support ongoing operations or achieve profitability. The development and commercialization of the Company's products will require substantial development, regulatory, sales and marketing, manufacturing and other expenditures. The Company expects operating losses to continue through the foreseeable future as it continues to expend substantial resources to complete development of its products, obtain regulatory clearances or approvals and conduct further research and development.

Going Concern

The Company's financial statements have been prepared and presented on a basis assuming it will continue as a going concern. At December 31, 2007, the Company's current liabilities exceeded current assets by approximately $3.6 million and it had a capital deficit due principally to its recurring losses from operations. As of December 31, 2007, the Company was past due on payments due under its Convertible Notes payable in the amount of $481,000. In March 2007, the Company borrowed $2.8 million and repaid existing noteholders $1.2 million, including related interest. In addition, $1.9 million of existing loans were converted into secured convertible notes payable in March 2010 (see Note 9).

The Company was unsuccessful in raising additional capital during the fourth quarter of 2007. If sufficient capital cannot be raised at some point, in the third quarter of 2008, the Company might be required to enter into unfavorable agreements or, if that is not possible, be unable to continue operations, and to the extent practicable, liquidate and/or file for bankruptcy protection. As of the date hereof, the effort is on-going. These factors raise substantial doubts about the Company's ability to continue as a going concern. Additional debt or equity financing will be required for the Company to continue its business activities. The consolidated financial statements do not include any adjustments that might be required from the outcome of this uncertainty. If additional funds do not become available, the Company has plans to curtail operations by reducing discretionary spending and staffing levels. If funds are not obtained, the Company will have to curtail its operations and attempt to operate by only pursuing activities for which it has external financial support, such as the National Institute on Alcohol Abuse and Alcoholism ("NIAAA") contract and the National Cancer Institute ("NCI") funding. However, there can be no assurance that such external financial support will be sufficient to maintain even limited operations or that the Company will be able to raise additional funds on acceptable terms, or at all.

Management intends to obtain additional funds through sales of intangibles assets, debt or equity financings and collaborative partnerships. Management believes that debt or equity financing expected to be obtained in the second quarter of 2008, along with funds from government contracts and grants, and other strategic partnerships, will be sufficient to support planned operations through July 31, 2008, during which production of the Company's cervical cancer detection device could be launched.

The Company has been seeking a new strategic partner and on April 27, 2007, signed a 180-day exclusive negotiation feasibility study agreement of optimization of its microporation system for manufacturing, regulatory approval, commercialization and clinical utility with a company that is interested in our technology. The exclusive negotiation agreement expired on October 27, 2007. The Company was paid a fee in this regard of $100,000, which has been recognized in income ratably over the six months period, in other income on the statement of operations. Currently, the Company is working on extending the agreement for an additional six months. Another partner interested in our technology is currently considering a long-term agreement with the Company. Presently the partner pays the Company fees of $250,000, while the consideration is on-going.

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2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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. Significant areas where estimates are used include the allowance for doubtful accounts, inventory valuation and input variables for Black-Scholes calculations.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Guided Therapeutics and its wholly owned subsidiaries, Sterling and InterScan. All significant intercompany balances and transactions have been eliminated.

Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be a cash equivalent.

Advertising Costs

All advertising costs are expensed as incurred. Approximately $3,000 was charged to advertising expense for the years ended December 31, 2006. However, there was no advertising expense for the year ended December 31, 2007, due to the sale of SimpleChoice product line.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is computed using the straight-line method over estimated useful lives of three to seven years. Expenditures for repairs and maintenance are expensed as incurred. Property and equipment are summarized as follows at December 31, 2006 and 2007 (in thousands):

	Year Ended December 31,	
	2006	2007
Equipment	$1,431	$1,433
Furniture and fixtures	479	484
	1,910	1,917
Less accumulated depreciation	(1,891)	

	(1,899)
Total	
	$19
	$18

Patent Costs (Principally Legal Fees)

Costs incurred in filing, prosecuting, and maintaining patents are expensed as incurred. Such costs aggregated approximately $377,000 and $484,000 in 2006 and 2007, respectively.

Accounts Receivable

There were significant concentrations of credit risk in 2007, majority of our receivables are from National Institute of Alcohol Abuse and Alcoholism (NIAAA), LifeScan, Inc. US and the MacKay group. The Company performs periodic credit evaluations of its customers' financial condition and generally does not require collateral. The Company reviews all outstanding accounts receivable for collectability on a quarterly basis. An allowance for doubtful accounts is recorded for any amounts deemed uncollectable.

Accrued Liabilities

Accrued liabilities are summarized as follows at December 31, 2006 and 2007 (in thousands):

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	Year Ended December 31,	
	2006	2007
Accrued compensation	$367	$337
Rent	105	81
Other accrued expenses	162	

		288
Total	$634	$706

Revenue Recognition

The Company records revenue from product sales at the time the product is shipped and title passes pursuant to the terms of the agreement with the customer, the amount due from the customer is fixed or determinable, and collectability of the related receivable is reasonably assured. Revenue is recorded, which includes all shipping and handling costs, and recognized only when the Company has no significant future performance obligation or we and the collaborative partner agree that a milestone has been achieved. Revenue from collaborative agreements is recorded when performance targets have been met. In the past, we received funds from collaborative agreements in two forms - milestone payments based upon achieving certain performance targets and reimbursement of research and development expenses. Milestone payments are recorded as revenue and payments for expense reimbursement are recorded as a reduction of expense not revenue. Although some of the Company's products have expiration dates, the Company has not had to issue any credits or allowances for expired products to date, as no related expense has been incurred.

Service revenues are considered to have been earned when the Company has substantially accomplished what it must do to be entitled to the benefits represented by the service revenues. Accordingly, the Company records revenue from service contracts where the service is completed and the customer is invoiced in accordance with the terms of a written, duly executed service contract or purchase order.

If the collectability of assets received for product sales, services, milestone or license fees is doubtful, the revenues are recognized on the basis of cash received. The Company has relied upon Securities and Exchange Commission Staff Accounting Bulletin ("SAB") 101 and SAB 104 for its recognizing revenue and related costs.

In 2007, the majority of our revenues were from NIAAA, LifeScan, Inc. US, Konica Minolta and the MacKay group.

Research and Development

Research and development expenses consist of expenditures for research conducted by the Company and payments made under contracts with consultants or other outside parties and costs associated with internal and contracted clinical trials. All research and development costs are expensed as incurred. Research and development expense reimbursements, such as grants, are offset against expenses.

Income Taxes

The Company uses the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Management provides valuation allowances against the deferred tax assets for amounts that are not considered more likely than not to be realized.

Stock Based Compensation

Prior to December 31, 2005, the Company used the intrinsic value method for valuing its employee/director awards of stock options and recording the related compensation expense, if any, in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. No stock-based employee or director compensation cost for stock options is reflected in the net loss, as all options granted have exercise prices equal to the market value of the underlying common stock on the date of grant. The Company records compensation expense related to options granted to non-employees based on the fair value of the award.

Effective January 1, 2006, the Company adopted SFAS No. 123 (Revised 2004), "Share Based Payment," which requires public companies to measure the cost of employee, officer and director services received in exchange for stock-based awards at the fair value of the award on the date of grant. SFAS No. 123R supersedes the Company's previous accounting under SFAS No. 123, "Accounting for Stock-Based Compensation," which permitted the Company to account for such compensation under APB Opinion No. 25, "Accounting for Stock Issued to Employees." In accordance with APB No. 25 and related interpretations, no compensation cost had been recognized in connection with the issuance of stock options, as all options granted under the Company's stock option plan had an exercise price equal to or greater than the market value of the underlying common stock on the date of the grant.

The Company applied the modified prospective transition method upon adoption of SFAS No. 123R. Under the modified prospective transition method, compensation cost is required to be recorded as earned for all unvested stock options outstanding at the beginning of the first year of adoption of SFAS No.123R based upon the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and for compensation cost for all share-based payments granted or modified subsequently based on fair value estimated in accordance with the provisions of SFAS No. 123R. The Company's financial statements as of and for the year ended December 31, 2007 reflect the impact of SFAS No. 123R but, in accordance with the modified prospective transition method, the Company's financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123R.

For the year ended December 31, 2007, share-based compensation for options attributable to employees and officers was $31,000, and has been included in the Company's 2007 statement of operations. Compensation costs for stock options which vest over time are recognized over the vesting period. As of December 31, 2007, the Company had $178,000 of unrecognized compensation cost related to granted stock options to be recognized over the remaining vesting period of approximately four years.

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, and other financial instruments approximate their fair values principally because of the short-term maturities of these instruments.

New Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 141 (revised 2007), "Business Combinations" (hereinafter "SFAS No. 141 (revised 2007)"). This statement establishes principles and requirements for how an acquirer a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree, b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase and c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The scope of SFAS No. 141 (revised 2007) is broader than the scope of SFAS No. 141, which it replaces. The effective date of SFAS No. 141 (revised 2007) is for all acquisitions in which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of this statement is not expected to have a material effect on the Company's financial condition or results of operations.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51" ("SFAS No. 160"). This statement establishes accounting and reporting standards that require a) the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled and presented in the consolidated statement of financial position with equity, but separate from the parent's equity, b) the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income, c) changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently, d) when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value and e) entities provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. The effective date of this standard is for fiscal years and interim periods beginning on or after December 15, 2008. The adoption of this statement is not expected to have a material effect on the Company's financial condition or results of operations.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115" ("SFAS No.159"). SFAS No. 159 allows companies to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 will become effective for the Company beginning in fiscal 2009. The Company is currently evaluating what effects the adoption of SFAS No. 159 will have on the Company's future results of operations and financial condition.

In September 2006, the SEC issued SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ("SAB No. 108"). SAB No. 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of determining whether the current year's financial statements are materially misstated. SAB No. 108 was effective for the Company beginning October 1, 2007. The adoption of SAB No. 108 did not have a material impact on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157"). SFAS No. 157 provides guidance for using fair value to measure assets and liabilities and requires additional disclosure about the use of fair value measures, the information used to measure fair value, and the effect fair-value measurements have on earnings. The primary area in which the Company utilizes fair value measures is evaluating long-term assets for potential impairment. SFAS No. 157 does not require any new fair value measurements. SFAS No. 157 is effective for the Company beginning January 1, 2008. The adoption of this statement is not expected to have a material effect on the Company's financial condition or results of operations.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement 109* ("FIN 48"), which prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return, including a decision whether or not to file a return in a particular jurisdiction. Under this new guidance, the financial statements will reflect expected future tax consequences of such positions presuming the taxing authorities' full knowledge of the position and all relevant facts, but without considering time values. This guidance also revises disclosure requirements and introduces a prescriptive, annual, tabular roll-forward of unrecognized tax benefits. FIN 48 is effective for annual periods beginning after December 15, 2006. The adoption of this statement did not have a material effect on the Company's financial condition or results of operations.

In June 2006, the FASB ratified the consensus reached by the EITF in Issue No. 06-3, How *Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)* ("EITF 06-3"). The scope of this issue includes any tax assessed by a governmental authority that is directly imposed on a revenue-producing activity between a seller and a customer and may include, but is not limited to, sales, use, value-added, and some excise taxes. EITF 06-3 requires the disclosure of the method of accounting for the applicable assessed taxes and the amount of assessed taxes that are included in revenues if they are accounted for under the gross method and are significant. EITF 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. The adoption of EITF 06-3 in 2007 did not have an impact on its consolidated financial statements.

3. Sale of Assets

On May 9, 2007 (the "Closing"), the Company and Sterling, sold to ICU Medical, Inc. (the "Buyer"), substantially all of the assets of the Company related to the field of subcutaneous fluid delivery, including certain equipment and intellectual property pursuant to a certain Asset Sale Agreement (the "ASA") executed and delivered at the Closing by the Sellers and Buyer. In connection with the sale, SpectRx, Inc. announced the termination of further sale of any SimpleChoice products. The Buyer also assumed certain liabilities in connection with the sale of the Purchased Assets pursuant to the ASA.

The selling price for the assets was $3,000,000, and after adjustment for certain escrow amounts and escrow fees, the Company received $2,688,661 in total. The Company recorded a gain on sale in the amount of approximately $2.1 million (net of tax) on its statement of operations for the year ended December 31, 2007. The Company does not anticipate an income tax impact from the gain on sales based on utilizing its net operating loss carryforwards. The preceding statement assumes that there are currently no limitations in place that would limit the ability of the Company to utilize its NOL carryforwards. However, the Company may be subject to alternative minimum tax liability. This is due to limits placed on a company's ability to utilize NOLs to offset alternative minimum taxable income.

The ASA contemplates certain additional payments from the Buyer to the Company, or Sterling, of 0.5% on annual net sales of covered products between $10,000,000 and $20,000,001; 0.75% on annual net sales of covered products between $20,000,001 and $30,000,000 and 1.5% on annual net sales of covered products over $30,000,001, after closing, not to exceed $1,000,000 in any calendar year, relating to sales of products covered by a certain patent entitled "Infusion Hub Assembly and Fluid Line Disconnect System." Additionally, the Buyer granted the Company a license to make, use, or sell products covered by a certain patent relating to "Insertion Device for an Insertion Set and Method of Using the Same" and the Company agreed to make certain royalty payments to the Buyer of 0.5% on annual net sales of covered products between $10,000,000 and$20,000,001; 0.75% on annual net sales of covered products between $20,000,001 and $30,000,000 and 1.5% on annual net sales of covered products over $30,000,001, not to exceed $1,000,000 in any calendar year, on sales of products covered by this patent.

Income (loss) from discontinued operations includes the following (in thousands):

	Year Ended December 31,	
	2006	2007
Loss from operations	$(1,460)	$(295)

Gain on sale of disposal, net of taxes	-
	2,086
Total	$(1,460)
	$1,791

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4. Stockholders' Equity

Common Stock

On October 25, 2007, the Company's stockholders approved an increase in the number of authorized shares of common stock from 50,000,000 to a total of 100,000,000 shares and a reverse stock split in a ratio ranging from one-for-two to one-for-ten of all issued and outstanding shares of common stock, the final ratio to be determined within the sole discretion of the Board of Directors. As of the filing date of this report, no reverse stock split had taken place.

Preferred Stock

The Company has authorized 5,000,000 shares of preferred stock with a $.001 par value. The board of directors has the authority to issue these shares and to set dividends, voting and conversion rights, redemption provisions, liquidation preferences, and other rights and restrictions.

Redeemable Convertible Preferred Stock

The board of directors designated 525,000 shares of the preferred stock as redeemable convertible preferred stock, none of which remain outstanding.

In November 1999, Abbott Laboratories, Inc. ("Abbott") subscribed to 525,000 shares of redeemable convertible preferred stock for consideration of $5,250,000 of which $2,750,000 was received in November 1999 and $2,500,000 was received in January 2000.

Dividends on the Abbott shares were payable in cash and accrued at the rate of $.60 per share per annum. Upon conversion, the Company, at its option, could pay accrued dividends in shares of common stock. The preferred shares, together with any accrued but unpaid dividends, were convertible into common shares at the greater of $9.39 per share or the average of the closing sales price for 15 days prior and 15 days subsequent to the conversion and any shares still outstanding were to automatically convert on December 31, 2004 at the then conversion rate. The shares were mandatorily redeemable at $10 per share, plus accrued but unpaid dividends, at the later of September 30, 2002 or 60 days subsequent to the date upon which the Company gives notice to Abbott of Abbott's right to redeem the shares. The shares had a liquidation preference of $10 per share, plus all accrued but unpaid dividends.

In September 2001, the Company entered into an agreement with Abbott whereby Abbott waived its right to redeem 100,000 shares of its redeemable convertible preferred stock plus the related accrued but unpaid dividends. On

December 31, 2004, these shares were automatically converted into 139,007 shares of common stock at $9.39 per share.

In September 2002, Abbott delivered notice of its election to cause the redemption of the 425,000 shares of the remaining redeemable convertible preferred stock eligible for redemption. On March 7, 2003, the Company reached a settlement with Abbott regarding their disputes in connection with the prior termination of the parties' Research & Development and License Agreement and the election of Abbott to have shares of the Company's preferred stock held by Abbott redeemed by the Company. Abbott had previously elected to have 425,000 shares of the Company's preferred stock redeemed, with 162,500 shares to be redeemed on December 30, 2002 at $10.00 per share, plus accrued dividends, and the remaining shares to be redeemed no later than January 31, 2004. Under the settlement, the Company had agreed to make quarterly payments to Abbott during 2003 and 2004 and end of the year lump sum payments in 2005 and 2006 to redeem 425,000 preferred shares and to pay accrued dividends as to such shares. The Company paid $400,000 and $300,000 to Abbott during 2003 and 2004, respectively. The Company's yearly financial obligations to Abbott under the agreement are approximately $1.4 million, $1.8 million and $1.9 million for 2004, 2005 and 2006, respectively. Under the settlement, neither party admitted any liability or wrongdoing (see Note 6. Commitments and Contingencies, Legal Proceedings).

Dividends were accrued on the non-redeemed preferred stock at a rate of 6% per year through December 31, 2002 and are included in the current portion of redeemable stock in the accompanying consolidated balance sheet. The terms of the Abbott preferred had an automatic conversion feature that was triggered automatically on December 31, 2004. After December 31, 2004, any Abbott preferred stock then outstanding would automatically convert into common shares.

Interest on the payments required under the September 2002 agreement was being accrued at the rate of 6% per year and was included with the redeemable preferred stock in the accompanying balance sheet. Interest expense related to the redeemable preferred stock included in the statements of operations for the years ended December 31, 2006 and 2007, was $453,000 and $250,000, respectively.

On December 31, 2004, the preferred stock held by Abbott automatically converted into 506,098 common shares. The Company did not issue these shares; however, the Company believed that Abbott has the voting rights associated with these shares.

The Company was in negotiations with Abbott from early 2003 through February of 2005 regarding the patent issue (see Note 6) and the payments of "outstanding accrued dividends" and "redemption" under the settlement. Abbott notified the Company that it was in default on four separate payments due in 2004 and demanded payment.

On February 17, 2005, the Company initiated litigation against Abbott relating to a dispute over intellectual property issues. The Company was represented in this matter under a contingency fee arrangement.

In connection with this matter, the Company has not paid approximately $5.8 million (including interest and dividends of approximately $453,000) of the amounts due through 2007.

On September 5, 2007, the Company and Abbott entered into a settlement and release, thereby settling pending legal disputes. As a result, Abbott has forgiven approximately $5.8 million in debt.

Series A Convertible Preferred Stock

At December 31, 2007, the Company had outstanding 418,175 shares of series A convertible preferred stock, having a stated value of $15.00 per share, plus five year warrants exercisable for 2,443,345 shares of the Company's common stock at an exercise price of $0.81 per share. The original conversion price of the series A convertible preferred was $1.50. As a result of the restructuring of certain notes payable in March 2007, the conversion price of the series A preferred stock was reduced from $1.50 to $0.65 and the warrant exercise price was reduced from $2.25 to $0.81. The re-pricing of the series A convertible preferred stock and the associated warrants triggered a deemed dividend of approximately $3.8 million in total. The deemed dividend has no effect on total capital deficit.

The holders of the series A convertible preferred stock are entitled to receive dividends per share at the per annum rate of 0.5% per share. Under the terms of the series A convertible preferred stock, the dividend is accrued from the original issue date and payable beginning March 26, 2006 and is thereafter payable quarterly in cash or stock, at the end of each calendar quarter, out of funds legally available therefor. The Company has experienced net losses since its inception, and, as of December 31, 2007, it had an accumulated deficit of approximately $64.6 million. The Company believes that no funds are legally available at this time and no dividend can be paid in stock or in cash. The series A convertible preferred stockholders have the right to vote on an as-converted basis.

Each share of series A convertible preferred stock is convertible into the number of shares of common stock equal to the quotient obtained by dividing the sum of (i) $15.00 (as adjusted for changes in the series A convertible preferred stock by stock split, stock dividend, and the like) referred to as the invested amount, plus (ii) all declared or accrued but unpaid dividends on such shares of series A convertible preferred stock, by the conversion price per share. The per share conversion price was $1.50, but was reset to $0.65 in March 2007 (see Note 9). The conversion price is subject to adjustment under certain circumstances to protect the holders of series A convertible preferred stock from dilution relative to certain issuances of common shares, or securities convertible into or exercisable for common shares. Subject to certain exceptions, if the Company issues common shares, or such other securities, at a price per share less than the then effective conversion price, the conversion price will be adjusted to equal such lower per share consideration.

During the twelve months ended December 31, 2006, 5,200 shares of series A convertible preferred stock ($48,000 face value), along with accrued dividends ($8,000), were converted into 57,421 shares of the Company's common stock. For the year ended December 31, 2007, 65,249 shares of series A convertible preferred stock ($607,000 face value), were converted into 1,368,000 shares of the Company's common stock.

Stock Options

Under the Company's 1995 Stock Plan (the "Plan"), a total of 3,294,719 shares remained available at December 31, 2007 and 3,160,500 shares were subject to stock options outstanding as of that date, bringing the total number of shares subject to stock options outstanding and those remaining available for issue to 6,455,219 shares of common stock as of December 31, 2007. The Plan allows the issuance of incentive stock options, nonqualified stock options, and stock purchase rights. The exercise price of options is determined by the Company's board of directors, but incentive stock options must be granted at an exercise price equal to the fair market value of the Company's common stock as of the grant date. On November 12, 2007, the board of directors approved the grant of incentive stock options for 1,057,000 shares to employees, at the closing price of $0.30 per share. Options historically granted have generally become exercisable over four years and expire ten years from the date of grant. Additionally, on December 14, 2007, the board of directors approved the grant of incentive stock options for 500,000 shares to one of its Directors, at the closing price of $0.25 per share. Options generally become exercisable over four years and expire ten years from the date of grant.

In January 2002, the Company assumed the Sterling Medivations 2000 Stock Option Plan, which authorizes the issuance of up to 93,765 shares of the Company's common stock. No options have been exercised under this plan. At December 31, 2007, options exercisable for 6,090 shares were outstanding under this plan.

Stock option activity for each of the two years ended December 31 is as follows:

	2007		2006	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	2,034,105	$2.78	3,015,608	$2.09
Options granted (1)	1,557,000	$0.30	-	-
Options exercised	(20,666)	$0.26	(59,959)	$0.51
Options expired/forfeited (2)	(409,939)	$3.86		

	(921,544)
	$1.15
Outstanding at end of year	
	3,160,500
	$1.43
	2,034,105
	$2.78
Options vested or expected to vest at year-end	
	3,160,500
	$1.43
	2,034,105
	$2.78
Options exercisable at year-end	
	1,141,999
	$3.37
	1,389,171
	$3.86
Options available for grant at year-end	
	3,294,719
	441,780
Aggregate intrinsic value - options exercised	
	$9,752

$3,526

Aggregate intrinsic value - options outstanding

$0.00

$44,950

Aggregate intrinsic value - options exercisable

$0.00

$15,198

(1) For 2007, only, includes 1,057,000 options granted on November 12, 2007. Approximately $31,000 of compensation expense was recognized for the year ended December 31, 2007.

(2) For 2006, only, includes 500,000 options which required stockholder approval within 12 months in order to be valid. Shareholder approval was not obtained.

The following table sets forth or the range of exercise prices, number of shares issuable upon exercise, weighted average exercise price, and remaining contractual lives by groups of similar price as of December 31, 2007:

Range of Exercise Prices	Options Outstanding		Options Exercisable
	Number of Shares		

Weighted Average Exercise Price

Weighted Average Contractual Life (years)

Number
of Shares

Weighted
Average
Price

$ 0.23 - $ 0.26

1,339,500

$ 0.25

8.61

380,874

$ 0.25

$ 0.30

1,057,000

$ 0.30

9.87

22,021

$ 0.30

$ 0.34 - $ 0.70

59,000

$ 0.34

6.87

53,854

$ 0.34

$ 1.10 - $ 4.46	262,000	$ 1.75	5.33	252,250	$ 1.75
$ 5.00 - $ 9.00	388,000	$ 7.12	1.44	378,000	$ 7.07
$ 10.13 - $ 16.50	55,000	$ 11.25	2.40	55,000	$ 11.25
Total	3,160,500	$ 1.43	7.74		

1,141,999

$ 3.37

In December 2001, as a result of the acquisition of Sterling, the Company granted options to purchase 22,024 shares of common stock at an exercise price of $7.29 per share in exchange for all the outstanding options, vested and unvested, of Sterling. As of December 31, 2007, 6,090 of these shares have not been exercised.

During the year ended December 31, 2004, the Company recorded, as deferred compensation, $10,000 in connection with non- qualified options to purchase 31,000 shares of common stock issued to a consultant. These options were issued in exchange for services to be provided. Approximately $4,000 and $31,000 was expensed in 2006 and 2007, respectively, relating to these options.

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Company shares reserved as of December 31, 2007 are as follows:

	Common Shares
Options issued and outstanding under employee incentive plans	3,160,500
Options available under employee incentive plans	3,294,719
Warrants	11,792,599
Conversion of preferred shares [(1)]	9,650,192
Total	27,898,010

[(1)] As a result of the restructuring of the Company's debt in March 2007 (see Note 9), the conversion price of the Company's outstanding series A convertible preferred stock, totaling 483,469 shares was reduced from $1.50 to $0.65 per share. Accordingly, the number of shares of common stock reserved increased from 4,834,690 to 11,156,977. At December 31, 2007, 418,175 shares of the Company's series A convertible preferred stock are outstanding.

The Company estimates the fair value of stock options using a Black-Scholes valuation model. Key input assumptions used to estimate the fair value of stock options include the expected term, expected volatility of the Company's stock, the risk free interest rate, option forfeiture rates, and dividends, if any. The expected term of the options is based upon the historical term until exercise or expiration of all granted options. The expected volatility is derived from the historical volatility of the Company's stock on the U.S. Over the Counter market for a period that matches the expected term of the option. The risk-free interest rate is the constant maturity rate published by the U.S. Federal Reserve Board that corresponds to the expected term of the option.

SFAS No. 123R requires forfeitures to be estimated at the time of grant in order to estimate the amount of share based awards that will ultimately vest. The estimate is based on the Company's historical rates of forfeitures. Share based compensation expense recognized by the Company in 2006 includes (i) compensation expense for share based awards granted prior to, but not yet vested as of December 31, 2005, based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS No. 123 and (ii) compensation expense for the share based payment awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. This is based on awards ultimately expected to vest.

In the Company's pro forma information required under SFAS No. 123 for the periods prior to 2006, the Company accounted for forfeitures as they occurred. SFAS No. 123R also requires estimated forfeitures to be revised, if necessary in subsequent periods if actual forfeitures differ from those estimates. The dividend yield is assumed as 0% because the Company has not paid dividends and does not expect to pay dividends in the near future. The Company has used the following assumptions to calculate fair value of options granted:

-

Year Ended December 31,	2005
Expected term in years	4
Risk-free interest rate	4.67%
Expected volatility	128%
Dividend yield	0%

Warrants

The Company has the following shares reserved for the warrants outstanding as of December 31, 2007:

Warrants	Exercise Price

Expiration Date

54,000

(1)

$2.25

08/30/2008

189,000

(2)

0.65

08/30/2013

400,000

(3)

0.65

02/05/2014

68,000

(4)

		0.65	11/20/2013
100,000	(5)	2.00	07/07/2009
2,443,345	(6)	0.81	03/25/2009
407,336	(7)	1.50	03/25/2009
7,485,061	(8a)	0.78	02/23/2012
461,000	(8b)	0.78	03/01/2009
169,857	(9)	0.78	03/01/2009

15,000

(10)

0.78

03/01/2012

11,792,599

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(1)

Consists of warrants to purchase common stock at a purchase price of $2.25 per share issued as part of a bridge loan financing completed in 2003 and extended in February of 2004. These warrants are exercisable in cash and not subject to any repricing.

(2)

Consists of amended and restated warrants to purchase common stock at a purchase price of $1.50 per share associated with the settlement of a dispute in August of 2005, the warrant modification required adding five years to the warrant terms. These warrants are exercisable either in cash or in stock, if the fair market value is greater than the exercise price, and are subject to repricing on the same terms as the series A convertible preferred stock. As of March 2007, the exercise price was adjusted from $1.50 to $0.65 per share. At March 31, 2007, approximately $6,000 was charged to expense, based on the repricing.

(3)

Consists of amended and restated warrants to purchase common stock at a purchase price of $1.50 per share associated with the settlement of a dispute in August 2005, which settlement resulted in adding five years to the warrant terms. These warrants are exercisable either in cash or in stock, if the fair market value is greater than the exercise price, and are subject to repricing on the same terms as the series A convertible preferred stock. As of March 2007, the exercise price was adjusted from $1.50 to $0.65 per share. At March 31, 2007, approximately $11,000 was charged to expense, based on the repricing.

(4)

Consists of amended and restated warrants to purchase common stock at a purchase price of $1.50 per share associated with the settlement of a dispute in August 2005, which settlement resulted in adding five years to the warrant terms. These warrants are exercisable either in cash or in stock, if the fair market value is greater than the exercise price, and are subject to repricing on the same terms as the series A convertible preferred stock. As of March 2007, the exercise price was adjusted from $1.50 to $0.65 per share. At March 31, 2007, approximately $2,000 was charged to expense, based on the repricing.

(5)

Consists of warrants to purchase common stock at a purchase price of $2.00 per share issued as part of the extension of a bridge loan financing in February 2004. These warrants are exercisable in cash and not subject to any repricing.

(6)

Consists of warrants to purchase common stock issued as part of the private placement of the Company's series A convertible preferred stock completed in 2004. These warrants are exercisable in cash and are subject to repricing. As of March 12, 2007, the exercise price was adjusted from $2.25 to $0.81. Included in the deemed dividend of $3,811,000 to Series A convertible preferred shareholders due to the repricing of the Series A convertible preferred stock and warrants on March 12, 2007, is approximately $150,000 attributable to the repricing of the 2,443,345 Series A warrants.

(7)

Consists of warrants to purchase common stock at a purchase price of $1.50 per share issued as placement agent fees and in connection with the private placement of the Company's series A convertible preferred stock completed in 2004. These warrants have a cashless exercise provision or are exercisable in cash and not subject to any repricing.

(8a-b)

Consists of warrants to purchase common stock at a purchase price of $0.78 per share issued in conjunction with an amended and restated loan agreement, executed in March 2007. On March 12, 2007, the relative fair value of the warrants was approximately $2.3 million (including $.3 million attributed to 661,000 warrants for placement agent fees treated as debt issuance cost), and the relative fair value of the beneficial conversion feature was approximately $1.5 million. The debt discount, consisting of the beneficial conversion feature and warrants, will accrete over the 36-month term of the convertible notes payable under the agreement using the effective interest method. In addition, debt issuance costs totaling approximately $811,000 ($520,000 cash costs and $291,000 warrant value for 661,000 warrants issued to the placement agents and others) will also be amortized over thirty-six months, using the effective interest method.

(9)

Consists of warrants to purchase common stock at a purchase price of $0.78 per share. The warrants were issued in connection with prior extension of the maturity date of the currently past due bridge notes payable in March 2007. The fair value of these warrants was approximately $64,000 and is included in interest expense for the nine months ended September 30, 2007. These warrants are exercisable either in cash or stock, if the fair market value is greater than the exercise price. Note: There is no anti-dilution protection in these warrants, only adjustment for reorganizations, etc.

(10)

Consists of warrants to purchase common stock at a purchase price of $0.78 per share issued in conjunction with an amended and restated loan agreement, executed in March 2007. These warrants are exercisable either in cash or in stock, if the fair market value is greater than the exercise price. The fair value of these warrants was approximately $6,000 at March 31, 2007. This amount has been expensed in the Company's statement of operations for the nine months ended September 30, 2007.

In connection with certain financing, which became due and payable as of January 30, 2004, and under an agreement dated February 6, 2004, the Company agreed to cause its subsidiary, InterScan, to issue to the lenders party to the agreement, InterScan warrants exercisable for the number of shares of common stock of InterScan equal to 5% of all shares of common stock of InterScan as of and after the issuance of InterScan securities in an InterScan financing, as defined in the agreement. The exercise price per share of common stock of InterScan will equal 5% of the per share purchase price paid by the purchasers in such InterScan financing. As of December 31, 2007, no such InterScan financing had occurred.

Employee Stock Purchase Plan

The Company had adopted an employee stock purchase plan under which the Company could issue up to 214,286 shares of common stock. Eligible employees could use up to 10% of their compensation to purchase, through payroll deductions, the Company's common stock at the end of each plan period for 85% of the lower of the beginning or ending stock price in the plan period. At December 31, 2007, there were 0 shares available for future issuance under this plan. During the year ended December 31, 2006, the Company sold 16,000 shares valued at $4,000. The Company issued the last of these shares in May 2006; therefore, this plan is no longer available to employees.

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5. Income Taxes

The Company has incurred net operating losses ("NOLs") since inception. As of December 31, 2007, the Company had NOL carryforwards available through 2026, of approximately $60 million available to offset its future income tax liability. The NOL carryforwards begin to expire in 2008. The Company has recorded a valuation allowance for all NOL carryforwards. Utilization of existing NOL carryforwards may be limited in future years based on significant ownership changes. The Company is in the process of analyzing their NOL and has not determined if the Company has had any change of control issues that could limit the future use of NOL.

Components of deferred taxes are as follows at December 31 (in thousands):

	2006	2007
Deferred tax assets:		
Net operating loss carryforwards	$25,285	$22,760
Deferred tax liabilities:		
Intangible assets and other	(757)	(713)
	24,528	22,047
Valuation allowance	(24,528)	(22,047)
	$0	$0

The following is a summary of the items that caused recorded income taxes to differ from taxes computed using the statutory federal income tax rate for the years ended December 31:

	2006	2007
Statutory federal tax rate	34%	34%
State taxes, net of federal benefit	4	4
Nondeductible expenses	-	-
Valuation allowance	(38)	(38)
	0%	0%

6. Commitments and Contingencies

Operating Leases

Future minimum rental payments, at December 31, 2007, under non-cancellable operating leases for office space that expires in 2009 and equipment that expires in 2012 are as follows (in thousands):

2008	$281
2009	289
2010	20
2011	20
2012	20
Total	**$630**

Rental expense was $263,000 and $251,000 in 2006 and 2007, respectively.

Litigation and Claims

The Company has been subject to certain asserted and threatened claims, against certain intellectual property rights owned and licensed by the Company. A successful claim against intellectual property rights owned or licensed by the Company could subject the Company to significant liabilities to third parties, require the Company to seek licenses from third parties, or prevent the Company from selling its products in certain markets or at all. In the opinion of management based upon advice from counsel, there are no known claims against the Company's owned or licensed intellectual property rights that will have a material adverse impact on the Company's financial position or results of operations.

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Legal Proceedings

In January 2003, the Company announced that it was initiating actions required to terminate our research, development and license agreement with Abbott to jointly develop a continuous glucose monitor. The Company was withholding payment due in connection with the redemption of the shares of its preferred stock held by Abbott in connection with its claims under the agreement with Abbott. Under the terms of the preferred stock, 162,500 shares of the Company's preferred stock was required to be redeemed on December 30, 2002 at $10 per share. The Company had asked the U.S. patent office to resolve an inventorship dispute involving issued Abbott patents related to Abbott's glucose monitoring technology. Abbott exercised its right to terminate the agreement on January 7, 2003. The Company had reached a settlement with Abbott Laboratories regarding the disputes in connection with the prior termination of the parties' Research & Development and License Agreement and the election of Abbott to have shares of our preferred stock redeemed, with the 162,500 shares to be redeemed on December 30, 2002 at $10 per share, plus accrued dividends, and the remaining shares to be redeemed no later than January 31, 2004. Under the settlement, which included mutual releases, the Company agreed to make quarterly payments to Abbott during 2003 and 2004 and end of the year lump sum payments in 2005 and 2006 to redeem 425,000 preferred shares and to pay approximately $0.7 million, $1.3 million, $1.8 million and $1.9 million for 2003, 2004, 2005 and 2006, respectively. The Company paid $400,000 and $300,000 to Abbott pursuant to the settlement, respectively, during 2003 and in the first quarter of 2004. Under the settlement, neither party admitted any liability or wrongdoing.

On July 15, 2004, Abbott sent the Company a letter notifying that it was in default on two separate payments due in 2004 and demanded payment. On July 22, 2004 the Company responded that it was seeking to resolve the patent issues and renegotiate the payment terms. On October 25, 2004, Abbott sent a letter notifying that the Company was in default on an additional payment due in 2004 and demanded payment. The Company again responded that it expected to continue to seek to resolve the patent issues and renegotiate the payment terms.

On February 17, 2005, the Company initiated litigation against Abbott relating to the dispute over intellectual property issues. The Company is represented in this matter under a contingency fee arrangement. In connection with the dispute and litigation, the Company did not pay $0.9 million of the amount due in 2004, the $1.8 million due in 2005 or the $1.9 million due in 2006. These amounts have been shown as a current liability. On March 26, 2006, our lawsuit was stayed in order to allow arbitration to proceed.

On September 5, 2007, the Company and Abbott entered into a settlement and release thereby settling pending legal disputes. As a result, the Company has dropped its lawsuit and patent infringement claims against Abbott and Abbott has forgiven approximately $5.8 million in debt it claimed was in default. The dispute arose from a research, development and license agreement. The agreement was terminated in January 2003. Under the settlement, neither party admitted any liability or wrongdoing and agreed that no party will make any settlement payment to the other.

The Company has recorded the gain from debt forgiveness in the amount of $5.8 million in its statement of operations for the fiscal year ended December 31, 2007. The Company does not anticipate an income tax impact from the forgiveness of the debt based on utilizing its net operating loss carryforwards. The preceding statement assumes that there are currently no limitations in place that would limit the ability of the Company to utilize its NOL carryforwards. However, it should be noted that an alternative minimum tax liability may exist. This is due to limits placed on a company's ability to utilize NOLs to offset alternative minimum taxable income.

On February 22, 2005, we received a letter of patent infringement from ICU Medical, Inc. (ICU Medical) related to our SimpleChoice product line. We received the letter shortly after meeting with the CEO of ICU Medical to discuss partnering opportunities related to SimpleChoice. Management believes that the infringement claim is without merit and has provided information to ICU Medical that supports our position. There has been no further communication on this matter.

On December 6, 2006, Accellent, Inc. (Accellent), the manufacturer of our insulin infusion sets, attempted to file suit in the state court of Gwinnett County, Georgia against our wholly owned subsidiary, Sterling, seeking payment of an outstanding balance under the supply agreement between Accellent and Sterling. In addition to the outstanding principal balance, which Accellent claims to be $318,000, Accellent is also seeking accrued interest and attorney's fees, Sterling paid Accellent $178,500 in this regard in 2007. On February 7, 2008, this matter was resolved by mutual agreement with both parties. We received $26,371, as final settlement proceeds.

Roche

The Company has an agreement with Roche for the development, manufacturing, marketing and sale of a product that detects diabetes by laser fluorescence. The agreement requires Roche to make milestone payments based on progress achieved and to purchase diabetes screening products manufactured by the Company at a predetermined profit margin, subject to renegotiation between the parties in certain circumstances. The agreement also requires the Company to develop and manufacture diabetes screening products.

In July 1999, the Company received $381,000 in advance payments for inventory components with long lead times associated with the diabetes screening instrument from Roche. Neither the Company nor Roche, is currently conducting any activities related to this product, and there was no development activity on this product during 2006 or 2007. There have been no commercial sales of this product to end users.

Grants

In July 2006, the Company received a Small Business Innovation Research ("SBIR") grant from the NCI for $0.7 million. As of December 31, 2007, no more funds remained available under this July 2006 grant.

The Company files for reimbursement of the expenses incurred for activities conducted under the grant on a routine basis. All funds received from grants are recorded as reductions in research & development expenses on the Company's statements of operations.

Contracts

The Company has received contracts from the NIAAA and the Department of the Army to develop and test devices to sense alcohol and insulin growth factor, respectively, based upon the Company's interstitial fluid collection technology. The NIAAA contract runs for two years, and can be extended for an additional three years at their option. The Company was notified that it had received an extension for 2005 and was notified in March of 2006 that the NIAAA would to extend the contract further. The Company recognized $420,000 and $344, 000 of revenue upon completion of certain activities specified under the NIAAA contract during 2006 and 2007, respectively. In 2007, the Company received no revenue from the contact with the Army.

7. License and Technology Agreements

As part of the Company's efforts to conduct research and development activities and to commercialize potential products, the Company, from time to time, enters into agreements with certain organizations and individuals that further those efforts but also obligate the Company to make future minimum payments or to remit royalties ranging from 1% to 3% of revenue from the sale of commercial products developed from the research.

The Company generally is required to make minimum royalty payments for the exclusive license to develop certain technology. In accordance with the renegotiation of the license for the glucose monitoring technology in 2001, the minimum required payment to Altea Technology, Inc. was reduced to $300,000 per year subject to certain adjustments, starting in 2005, to maintain this license. The Company has not had any significant sales of products covered by this license, however additional amounts will be due upon the Company achieving significant sales.

The Company was required to make advances on royalty payments in 2002. During 2006 and 2007, the Company recognized royalty expense of $341,000 and $364,000, respectively, which has been recorded as research and development expense.

Additionally, the Company is obligated to obtain and maintain certain patents, as defined by the agreements.

8. Business Concentration Information

Geographic Information

The Company operates in one business segment, medical products. During fiscal years 2006 and 2007, total revenue was $602,000 and $1,037,000, respectively. All sales are payable in United States dollars. Product and service revenue attributable to countries based on the location of the customer is as follows (in thousands):

	2006	2007
United States and Canada	$602	$1,037
Total	$602	$1,037

9. Notes Payable

On February 3, 2006, InterScan obtained a $1.5 million loan, evidenced by promissory notes in favor of each of the investors. Proceeds of the loan have been used by InterScan to fund its product development work and its general working capital needs, and to reimburse the Company for certain expenses incurred or to be incurred by it on behalf of InterScan. The interest rate on the notes is 10% per annum and the notes matured on August 2, 2006.

On February 27, 2006, the Company borrowed an additional $400,000 through a note purchase and security agreement. The interest rate on the note was 15% per annum and the note was to mature on August 2, 2006. This note was paid in full on June 28, 2006.

On June 28, 2006, the Company entered into a bridge loan agreement ("Bridge Loan Agreement") with Easton Hunt Capital Partners, L.P., ProMed Offshore Fund II, Ltd., Mark Samuels, Richard L. Fowler and William Arthur, III, and ProMed Management, Inc., as agent for these lenders, pursuant to which each lender made a loan ("Loans") to the Company. At September 30, 2006, the aggregate principal amount of Loans was $1,592,000. From September 30, 2006 through December 31, 2006, an additional $444,000 was borrowed bringing the total to $2,036,000.

Subsequently, both Loans and the notes issued as payment for amounts due under the Loans were amended to provide for extensions through February 23, 2007. For the year ended December 31, 2006 and 2007, interest of approximately $254,082 and $358,000, respectively, was incurred on the notes.

On March 1, 2007, the Company issued four new short-term unsecured promissory notes as payment for all amounts due under the Bridge Loan Agreement as follows: one in the amount of $53,049, to replace an original note (principal and interest), issued on September 22, 2006; two in the amount of $106,367 each, to replace the two original notes issued on September 15, 2006, and one in the amount of $158,860 to replace an original note issued on September 15, 2006. The notes matured on June 30, 2007 and contain an obligation to issue a total of warrants to purchase 169,857 shares of the Company's common stock at $0.78 per share. The fair value of these warrants was approximately $64,000 at December 31, 2007. This amount has been expensed in the Company's statement of operations for the period then ended. An additional extension is currently being negotiated with the lenders. Warrants have been issued; however, the notes are past due.

On March 12, 2007, the Company completed a restructuring of its then-existing indebtedness by entering into an Amended and Restated Loan Agreement ("Amended Loan") with existing and new creditors. Pursuant to the Amended Loan, the Company's then-existing indebtedness was restructured and consolidated into new 13% senior secured convertible notes (the "Convertible Notes"). The aggregate principal amount of the Amended Loan is approximately $4.8 million due on March 1, 2010. No interest is due until maturity, absent an event of default under the Amended Loan. If an event of default occurs and is continuing, the interest rate on the Amended Loan becomes 18%. These notes are convertible into of the Company's common stock at $0.65 per share, or 7,285,061 shares of common stock, and were issued with approximately 7.2 million warrants, exercisable immediately at $0.78 per share for the Company's common stock. Additionally, accrued interest on the Convertible Notes is convertible into shares of common stock of the Company on the same terms. In addition, 661,000 warrants at an exercise price of $0.78 were also issued to the placement agent and others in conjunction with this financing, as well as a warrant to purchase 15,000 shares of the Company's common stock at $0.78, as part of interest expense to a non-converting bridge note holder, as interest on the notes payable. The fair value of the warrant to purchase 15,000 shares of the Company's common stock was approximately $6,000 at December 31, 2007. This amount was expensed in the Company's statement of operations for the period then ended. The conversion price and the exercise price of the warrants are subject to adjustments for anti-dilution.

On March 12, 2007, the relative fair value of the warrants was approximately $2.3 million (including $.3 million attributed to 661,000 warrants for placement agent fees treated as debt issuance cost), and the relative fair value of the beneficial conversion feature was approximately $1.3 million. The debt discount, consisting of the beneficial conversion feature and warrants, will accrete over the 36-month term of the Convertible Notes payable using the effective interest method. In addition, debt issuance costs totaling approximately $811,000 ($520,000 cash costs and $291,000 warrant value for 661,000 warrants issued to the placement agents and others will also be amortized over 36 months, using the effective interest method.

The Amended Loan is a senior secured obligation of the Company's and is secured by (a) a first in priority lien on all of the Company's assets; (b) a guaranty by Sterling; (c) a lien on all of Sterling's assets; and (d) a pledge on all issued and outstanding stock of Sterling and InterScan, except for the sale of the Company's SimpleChoice business unit and related intellectual property.

The Amended Loan also provides certain registration rights with respect to the shares of the Company's common stock underlying the Convertible Notes and warrants to the lenders. In addition, the Convertible Notes will automatically convert into convertible preferred stock of the Company, upon any completion of a convertible preferred financing of $5 million or more. The penalty for the late registration of the underlying common stock, as outlined in the Amended Loan, is calculated as 1/90th of 1% for each late day. This calculation resulted in a penalty accrual of approximately $91,000 for the year ended December 31, 2007, as the Company currently expects that the registration statement will not be filed.

Of the proceeds from the Amended Loan, approximately $1.9 million was used to convert debt from the previous loans into debt from the Amended Loan, and approximately $1.2 million was used to retire debt from the previous loans.

The issuance of the Convertible Notes and the warrants changed the conversion price of the Company's series A convertible preferred stock from $1.50 to $0.65, the exercise price of certain of the Company's warrants from $2.25 to $0.81 and the exercise price of certain of the Company's warrants issued in August 2005 from $1.50 to $0.65, as described above under Note 5 (Stockholders' Equity). The re-pricing of the series A convertible preferred stock and the associated warrants triggered a deemed dividend of approximately $3.8 million in total. The deemed dividend has no net effect on stockholders' equity.

On April 17, 2007, the Company issued notes totaling approximately $440,827 to four officers and former officers representing unpaid salary (accrued as of December 31, 2006), pursuant to letter agreements executed in 2004 that would have become payable after the closing of the Amended Loan. The notes were in the amounts of: $188,721 to William D. Arthur, III, former President and Chief Operating Officer; $100,946 to Richard Fowler, Senior Vice President of Engineering; $86,445 to Thomas H. Muller, Jr., former Chief Financial Officer; and $64,715 to Walter Pavlicek, former Vice President of Operations. The notes were unsecured and were payable upon the sale of certain assets or at any time after August 28, 2007 when the Company had more than $1 million of cash on hand. Two of the notes had an interest rate of 13% and two of the notes had an interest rate of 7%, with interest accruing from March 1, 2007. These amounts could have been construed to be past due under the 2004 letter agreements. All notes and Mark Samuels' accrued salary were paid on May 18, 2007.

10.

Related Party Transactions

On August 8, 2005, warrants issued to Dr. Imhoff and his wife from August 2003 to February 2004, were amended and restated as of August 8, 2005. For Dr. Imhoff, warrants totaling 135,000 shares originally issued with an exercise price of $2.25 per share, were amended and restated with a $1.50 exercise price and a warrant for 250,000 shares for Dr. Imhoff, originally issued with an exercise price of $2.00 per share, was amended and restated with a $1.50 exercise price. For Susan Imhoff, a warrant for 25,000 shares originally issued with an exercise price of $2.00 per share was amended and restated with a $1.50 exercise price. All these warrants were also extended for an additional five years.

On February 3, 2006, InterScan obtained a $1.5 million loan, made by about a dozen individuals and entities including $375,000 by Dr. Imhoff. To evidence such borrowing, Guided Therapeutics executed promissory notes in favor of each of the investors. The interest rate on the notes was 10% per annum and the notes matured on August 2, 2006 (see Note 9).

On June 28, 2006, the Company entered into a bridge loan agreement (the "Bridge Loan Agreement") by and among Guided Therapeutics, Easton Hunt Capital Partners, L.P., ProMed Offshore Fund II, Ltd., Mark A. Samuels, Richard L. Fowler and William D. Arthur, III (each, a "Lender," and collectively, the "Lenders"), and ProMed Management Inc., as agent for the Lenders (the "Agent") pursuant to which each Lender made a loan (each a "Loan," and collectively, the "Loans") to the Company. These related parties represent the ownership of an aggregate of approximately 29% of the Company's common stock. Additionally, Mark A. Samuels is the former Chairman, Chief Executive Officer and Chief Financial Officer of SpectRx, Richard L. Fowler is the Senior Vice President-Engineering of Guided Therapeutics and William D. Arthur, III is the former President, Chief Operating Officer and Secretary, and a former director of SpectRx The aggregate principal amount of all Loans was originally $900,000 and was increased to $2,036,000 as of December 31, 2006 (see Note 9).

The Second Notes were senior secured obligations of the Company and were secured by (a) a first in priority lien on all of the Company's assets; (b) a guaranty by Sterling; (c) a second in priority lien on all of Sterling's assets; and (d) a pledge on all issued and outstanding stock of Sterling and InterScan. Both the February 2, 2006 and the June 28, 2006 notes were amended or converted into the Amended Loan (see Note 9).

On February 2, 2006, GT obtained a $1.5 million loan, including $375,000 from Dr. John E. Imhoff, a director of the Company. Evidencing such borrowing, GT executed promissory notes in favor of each of the investors. The interest rate on the notes was 10% per annum and the notes matured on August 2, 2006.

On June 28, 2006, the Company entered into a Bridge Loan Agreement with Easton Hunt Capital Partners, L.P., ProMed Offshore Fund II, Ltd., Mark Samuels, Richard L. Fowler and William Arthur, III, and ProMed Management, Inc., as agent for these lenders, pursuant to which each lender made a loan ("Loans") to SpectRx. At September 30, 2006, the aggregate principal amount of Loans was $1,592,000. From September 30, 2006 through December 31, 2006, an additional $444,000 was borrowed bringing the total to $2,036,000. Subsequently, both bridge loans and the notes were amended to provide for extensions through February 23, 2007. For the nine months ended September 30, 2007, interest of approximately $68,000 was incurred on the notes.

On March 12, 2007, the Company completed the restructuring of the Bridge Loan Agreement into an Amended and Restated Loan Agreement with existing and new creditors. Pursuant to the Amended Loan, the existing bridge loans, under the Bridge Loan Agreement, were restructured and consolidated into new 13% Senior Secured Convertible Notes, including those issued by GT, and new creditors became party to the Amended Loan. The aggregate principal amount of the Amended Loan is approximately $4.7 million due on March 1, 2010, of which related party transaction totaled approximately $1.9 million. No interest is due until maturity, absent an event of default under the Amended Loan. If the event of default occurs and is continuing, the interest rate on the Amended Loan is 18%. These notes are convertible into of the Company's common stock at $0.65 per share, or 7,285,061 shares of common stock, and were issued with approximately 7.2 million warrants, exercisable immediately at $0.78 per share for the Company's common stock. Additionally, accrued interest on the Convertible Notes is convertible into shares of common stock of the Company on the same terms. In addition, 661,000 warrants at an exercise price of $0.78 were also issued to the placement agent and others in conjunction with this financing, as well as a warrant to purchase 15,000 shares of the Company's common stock at $0.78, as part of interest expense to a non-converting Bridge Note holder, as interest on the notes payable. The fair value of the warrant to purchase 15,000 shares of the Company's common stock was approximately $6,000 at December 31, 2007. This amount has been expensed in the Company's statement of operations for the period then ended. The conversion price and the exercise price of the warrants are subject to adjustments for anti-dilution. The entire $4.7 million and accrued interest is considered a related party transaction, at December 31, 2007.

On March 12, 2007, the relative fair value of the warrants was approximately $2.3 million (including $.3 million attributed to 661,000 warrants for placement agent fees treated as debt issuance cost), and the relative fair value of the beneficial conversion feature was approximately $1.3 million. The debt discount, consisting of the beneficial conversion feature and warrants, will accrete over the 36-month term of the Convertible Notes payable using the effective interest method. In addition, debt issuance costs totaling approximately $811,000 ($520,000 cash costs and $291,000 warrant value for 661,000 warrants given to placement agent) will also be amortized over thirty-six months, using the effective interest method.

The Amended Loan is a senior secured obligation of the Company's and is secured by (a) a first in priority lien on all of the Company's assets; (b) a guaranty by Sterling; (c) a lien on all of Sterling's assets; and (d) a pledge on all issued and outstanding stock of Sterling and GT, except for the sale of the Company's SimpleChoice business unit and related intellectual property.

Subject to customary adjustments (which include full ratchet anti-dilution provisions), the Convertible Notes associated with the Amended Loan are convertible into approximately 7,285,061 common shares and the warrants are exercisable for approximately 7,946,061 shares of common stock, including warrants issued to placement agent. The warrants are currently exercisable. The Convertible Notes are convertible into the Company's common stock at a price of $0.65 per share and the warrants permit the holders to purchase shares of the Company's common stock at a price of $0.78 per share; both are subject to certain adjustments.

The Amended Loan also provides certain registration rights with respect to the shares of the Company's common stock underlying the Convertible Notes and warrants to the Amended Loan lenders. The Convertible Notes will automatically convert into convertible preferred stock, upon the completion of a convertible preferred financing of $5 million or more.

The issuance of the Convertible Notes and warrants was exempt from registration under the Securities Act of 1933, as amended (the "Securities Act"), pursuant to Section 4(2) of the Securities Act and Rule 506 of Regulation D promulgated thereunder. The facts relied upon to make the section 4(2) exemption available were: (i) no underwriters were involved in the issuance and sale of the convertible notes and warrants; (ii) the Amended Loan lenders were accredited, were experienced with transactions of this nature and had the ability to fend for themselves; (iii) the Convertible Notes and warrants were acquired by the Amended Loan lenders for investment only and not with a view to or for sale in connection with any distribution thereof, (iv) appropriate restrictive legends were affixed to the Convertible Notes and warrants, and (vi) the sales of the Convertible Notes and warrants were made without general solicitation or advertising.

The Amended Loan lenders include Mark A. Samuels, former Chairman, former Chief Executive Officer and former Acting Chief Financial Officer of SpectRx; Richard L. Fowler, Senior Vice President-Engineering of SpectRx; William D. Arthur, III, former President and former Chief Operating Officer of Sterling and former Secretary and a director of SpectRx; and, John E. Imhoff, a director of SpectRx, all of whom have a preexisting relationship with SpectRx, consisting of the ownership of an aggregate of approximately 29% of SpectRx's common stock (see Note 9).

The Company entered into the following agreements with some Executives:

SEVERANCE and CONSULTING AGREEMENT with Mark A. Samuels (the "Executive"): The Executive agreed to resign as Chairman and CEO, effective at the earlier of two days after the close of the sale of SimpleChoice or May 18, 2007 (the "Effective Date"), and was entitled to and did receive the following payments and benefits: All accrued salary (including back pay and interest, and missing paychecks in 2007) and accrued, but unused vacation pay, less applicable taxes and withholdings as required by law, through the Effective Date. Such amount was paid on May 18, 2007, totaling approximately $136,000. This amount was previously accrued.

The Executive was also paid $50,000 severance in one lump-sum distribution, on May 18, 2007.

In consideration for founding the Company and for almost 15 years of service, the Company agreed to pay the Executive two years severance at 50% of full salary (50% of $230,000 per year or $115,000 per year), to be paid out at the Company's normal two-week payroll interval, but not less than once every two weeks. The severance shall include full benefits not less than that offered to the new or interim CEO for a period of 24 months from date of severance. The Executive agreed to provide consulting services to the Company for 24 months at up to five hours per month, at no further cost to the Company. The Company has accrued the full unpaid severance, in the amount of $136, 120, in its statements of operations for the year ended December 31, 2007.

SEVERANCE and CONSULTING AGREEMENT with Dr. Walter Pavlicek: Upon the Effective Date of this Agreement, Dr. Pavlicek resigned as VP of Operations of Sterling Medivations, Inc. and was entitled to and did receive the following payments and benefits: All accrued salary (including back pay and interest, and missing paychecks in 2007) and accrued, but unused vacation pay, less applicable taxes and withholdings as required by law, through the Effective Date. Such amount was paid on May 18, 2007, totaling approximately $66,000. This amount was previously accrued.

Dr. Pavlicek was paid $35,000 in one lump-sum distribution, on May 18, 2007.

Dr. Pavlicek shall provide consulting for 12 months following the Effective Date to assist the Company with the International Standards Organization (ISO) audit preparations and ISO audit (which took place on June 6-8, 2007). Compensation for the consulting services shall be at regular two-week pay periods (starting May 18, 2007) at the rate of 1/26 of $35,000 per pay period.

In addition, the Company agreed to pay $10,000 upon the successful completion of the ISO audit. (Successful completion is defined as not losing certification.). This amount was paid on June 11, 2007.

SEVERANCE AGREEMENT with Mr. William Arthur: Upon the Effective Date of this Agreement, Mr. Arthur resigned as President and COO for Sterling Medivations, Inc., and was entitled to and did receive the following payments and benefits: All accrued salary (including back pay and interest, and missing paychecks in 2007) and accrued, but unused vacation pay, less applicable taxes and withholdings as required by law, through the Effective Date. Such amount was paid on May 18, 2007, totaling approximately $193,000. This amount was previously accrued.

Mr. Arthur was paid an amount equal to nine (9) months of his base salary, less applicable taxes and withholdings as required by law, which gross amount was divided and paid ½ cash and ½ as stock. Such cash payment equaled $67,500 and was paid on May 18, 2007. The net pay, using Mr. Arthur's current payroll deductions was $51,241, while the Company's closing stock price was $0.51, on May 18, 2007, translating to 100,472 shares issued to the manager.

EMPLOYMENT AGREEMENT with Mr. Richard L. Fowler: Upon the Effective Date of this Agreement, Mr. Fowler was entitled to and did receive the following payments and benefits: All accrued salary (including back pay and interest, and missing paychecks in 2007) and accrued, but unused vacation pay, less applicable taxes and withholdings as required by law, through the Effective Date. Such amount was paid on May 18, 2007, totaling approximately $103,000. This amount was previously accrued.

The Company signed an employment agreement with Mr. Fowler, continuing at his current position (Senior Vice president of Engineering). The employment agreement will be for a period of two years. The agreement will automatically renew for an additional period of two years.

11. Qualifying Accounts

Allowance for Bad and Doubtful Accounts

The Company has the following allowances for bad and doubtful debts (in thousands):

Balance as of December 31, 2006	$41
Additions during the year	0
	41
Charged to expense during the year (1)	(16)
Balance as of December 31, 2007	$25

(1) This amount represents amount previously written off, based on accounts receivable analysis.

12. (LOSS) INCOME PER COMMON SHARE

(Loss) income per common share is computed using SFAS No. 128, "Earnings per Share." SFAS No. 128 established standards for the computation, presentation and disclosure of earnings per share.

Basic net (loss) or income per share attributable to common stockholders amounts are computed by dividing the net (loss) or income plus preferred stock dividends and deemed dividends by the weighted average number of shares outstanding during the period.

No diluted per share amount is calculated when a loss from continuing operations exists, even though the Company has net income. Hence, potential dilutive securities for the year ended December 31, 2007, were excluded from the loss per share calculations due to the net loss from continuing operations and their anti-dilutive effect.

The reconciliation of the amounts used in the basic earnings per share computations are as follows (in thousands, except per share amounts).

	Year Ended December 31, 2007
Net (loss) income before discontinued operations	$1,225
Preferred stock dividends	(325)

Deemed dividend on Series A convertible preferred stock	(3,811)
(Loss) from continuing operations attributable to common stockholders, basic	(2,911)
Discontinued operations, net of tax	1,791
Net (loss) income attributable to common stockholders, basic	$(1,120)
Weighted average common shares outstanding	12,781
(Loss) per share from continuing operations	$(0.23)
(Loss) per share from d iscontinued operations	$0.14
Total	$(0.09)

13.

Subsequent Events

On December 6, 2006, Accellent, Inc. (Accellent), the manufacturer of our insulin infusion sets, attempted to file suit in the state court of Gwinnett County, Georgia against our wholly owned subsidiary, Sterling, seeking payment of an outstanding balance under the supply agreement between Accellent and Sterling. In addition to the outstanding principal balance, which Accellent claimed to be $318,000, Accellent was also seeking accrued interest and attorney's fees. On February 7, 2008, this matter was resolved by mutual agreement with both parties. We received $26,371.00, as final settlement proceeds.

On March 28, 2008, the Company entered into a collaborative option to license and no shop agreement with Konica Minolta Opto, Inc. ("KMOT") of Tokyo. Under terms of the agreement, KMOT will have a defined period of time to evaluate certain applications of GT's technology, including the potential adaptation of its LightTouch™ non-invasive cervical cancer detection technology to lung and biliary cancer. KMOT would also purchase prototype equipment and single use disposables.

On May 7, 2008, the Company was issued a new stock ticker symbol. The new symbol is GTHP. The company's shares are currently traded on the Pinks Sheets. The company was also issued a new CUSIP number, which is 40171F 105, and a new ISIN number, which is US40171F1057.

On March 31, April 1, April 2, and April 21, 2008, the Company issued four new short-term unsecured promissory notes as follows: each in the amount of $10,000 to board members Zachary, Imhoff, James and Hart, respectively. The non-interest bearing notes matured in sixty days from funding. Under the agreement, the notes are past due.

On April 30, 2008, the Company issued a new short-term unsecured promissory note to Delores Maloof in the amount of $400,000. The note matures on July 10, 2008, with an interest rate of 13%, and contains an obligation to issue a total of warrants to purchase 400,000 shares of the Company's common stock at $0.65 per share. This note can be converted into the Company's Existing 13% Senior Convertible Notes dated March 1, 2007, with equal entitlements, or can be converted into a new financing the Company may enter into, with the same terms as the new investors of such financing.

On May 25, 2008, ProMed Partners, LP and ProMed Offshore Fund, LTD, converted 42,274 and 6,800 series A convertible preferred shares to 975,554 and 156,923 common shares, respectively. There was no charge to the Company's statements of operations as a result of these transactions.

On June 1 and June 6, 2008, the Company received $100,000 and $200,000, respectively, as part of a new Convertible Bridge Note. Under the terms of the Note, an additional $100,000 will be funded, on or about June 15, 2008. This amount has not been received. The note is due and payable one year from the date of funding. This amount, which includes the principal plus 15% interest, contains an option to convert into a convertible note or other financing and carries a 20% warrant coverage at 65 cents. The note, as part of a new financing, is currently in legal review.

14. Accounting Changes and Error Corrections

On our previously filed Consolidated Statements of Operations for the year ended December 31, 2007, we included the gain on debt forgiveness of $5.8 million as part of operating income. Upon further review, under the guidance of FAS 154, the debt forgiveness was neither unusual in nature nor considered infrequent. Hence, we have reclassified the amount to "Non Operating Gain" on our statements of operations. All future filings will reflect the reclassification. Furthermore, we have amended the filing to separately disclose on the balance sheet the referenced related party notes payable in accordance with ARB 43, ch1 section A¶ 5. All future filings will reflect the change in description.

Item 9A. Controls and Procedures

The Company maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized, and reported, within the time periods specified in Securities and Exchange Commission ("Commission") rules and forms. The Company carried out an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer has concluded that our disclosure controls and procedures were ineffective as of December 31, 2007, due to the existence of a material weakness in our internal control over financial reporting, described below, and our failure to provide management's annual report on internal control over financial reporting in our annual report on Form 10-K filed July 15, 2008.

Management's Annual Report on Internal Control over Financial Reporting: Our management, including our chief executive officer and chief financial officer, is responsible for establishing and maintaining adequate internal control over our financial reporting. Internal control over financial reporting is a process designed by, or under the supervision of, our chief executive and chief financial officer and implemented by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorization of our management and directors; and (ii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements. Because of their inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control - Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation, our management concluded that our internal control over financial reporting was ineffective as of December 31, 2007, due to the existence of the material weakness described below:

Our Chief Executive Officer and Chief Financial Officer determined that a material weaknesses existed in our internal control over financial reporting resulting from inadequate resources in our accounting and financial reporting group - a result of our changes in senior management in the second quarter of the fiscal year. This was evidenced by our inability to timely file our annual report on Form 10-K for the fiscal year ended December 31, 2007 and our quarterly reports on Form 10-Q for the first and second fiscal quarters of 2008.

Further, management has identified that some processes for preparing the consolidated financial statements lack the appropriate controls to ensure the completeness, accuracy, appropriate valuation and proper presentation and disclosure of financial transactions.

Management believes it has plans to remediate these weaknesses by the hiring of a new CEO and acting CFO, the hiring of a new principal financial officer and implementation of new procedures and internal controls over financial reporting. The Company has also identified new Investing Partners.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the Commission that permit us to provide only the management's report in this Form 10-K.

There have been no changes in the Company's internal controls over financial reporting that occurred during the quarter ended December 31, 2007 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

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PART IV

ITEM 15. Exhibits and Financial Statement Schedules

The exhibits listed below are filed as part hereof, or incorporated by reference into, this Report. All documents referenced below were filed pursuant to the Securities and Exchange Act of 1934 by Guided Therapeutics, Inc. (f/k/a SpectRx, Inc.), file number 0-22179, unless otherwise indicated.

EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION
3.1	

	Certificate of Incorporation, as amended (incorporated by reference to Exhibit 3.1 to the Quarterly Report on Form 10-Q for the quarter ended June 30, 1997, filed August 12, 1997).
3.2	Certificate of Designations for Series A Convertible Preferred Stock (incorporated by reference to Exhibit 99.4 to the Current Report on Form 8-K, filed March 29, 2004).
3.3	Amended Bylaws (incorporated by reference to Exhibit 3.2A to the Annual Report on Form 10-K for the year ended December 31, 2003, filed March 30, 2004).
4.1	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Amended Registration Statement on Form S-1/A (No. 333-22429), filed April 24, 1997).
4.2	Form of Warrant 2 (incorporated by reference to Exhibit 99.6 to the Current Report on Form 8-K, filed March 29, 2004).
4.3	Registration Rights Agreement, dated March 26, 2004 (incorporated by reference to Exhibit 99.3 to the Current Report on Form 8-K, filed March 29, 2004).
4.4	Warrant Agreement, dated as of August 8, 2005, by and among SpectRx and the individuals listed on Exhibit A attached thereto (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K, filed August 12, 2005).
4.5	Form of Amended and Restated Warrant (incorporated by reference to Exhibit 4.2 to the Current Report on Form 8-K, filed August 12, 2005).
4.6	Form of Guided Therapeutics Warrant (incorporated by reference to Exhibit 4.3 to the Current Report on Form 8-K, filed August 12, 2005).
4.7	Amended and Restated Loan Agreement by and among SpectRx, Inc., the Agent, and the Noteholders, dated March 1, 2007 (incorporated by reference to Exhibit 4.1 to the Quarterly Report on Form 10-QSB, filed August 24, 2007).
4.8	First Amendment to the Amended and Restated Loan Agreement by and among SpectRx, Inc., the Agent, and the Noteholders, dated March 1, 2007 (incorporated by reference to Exhibit 4.2 to the Quarterly Report on Form 10-QSB, filed August 24, 2007).
10.1	1997 Employee Stock Purchase Plan and form of agreement thereunder (incorporated by reference to Exhibit 10.1 to the Registration Statement on Form S-1 (No. 333-22429) filed February 27, 1997).
10.2	1995 Stock Plan and form of Stock Option Agreement thereunder (incorporated by reference to Exhibit 10.2 to the Registration Statement on Form S-1 (No. 333-22429) filed February 27, 1997).
10.3	2000 Amendment to the 1995 Stock Plan, as amended (incorporation by reference to Appendix 1 to the Definitive Proxy Statement filed April 24, 2000).
10.4	2005 Amendment No. 2 to the 1995 Stock Plan, as amended (incorporated by reference to Exhibit 10 to the Amended Quarterly Report on Form 10-QSB/A, filed November 14, 2005).
10.5*	License Agreement, dated May 7, 1991, between Georgia Tech Research Corporation and Laser Atlanta Optics, Inc. (incorporated by reference to Exhibit 10.12(A) to the Registration Statement on Form S-1 (No. 333-22429) filed February 27, 1997).
10.6	First Amendment to License Agreement, dated October 19, 1993, between Georgia Tech Research Corporation and SpectRx (incorporated by reference to Exhibit 10.12(C) to the Registration Statement on Form S-1 (No. 333-22429) filed February 27, 1997).
10.7*	Development and License Agreement, dated December 2, 1994, between Boehringer Mannheim Corporation and SpectRx (incorporated by reference to Exhibit 10.14(A) to the Registration Statement on Form S-1 (No. 333-22429) filed February 27, 1997).

10.8*	Supply Agreement, dated January 5, 1996, between Boehringer Mannheim and SpectRx (incorporated by reference to Exhibit 10.14(B) to the Statement on Form S-1 (No. 333-22429) filed February 27, 1997).
10.9	Sole Commercial Patent License Agreement, dated May 4, 1995, between Martin Marietta Energy Systems, Inc. and SpectRx (incorporated by reference to Exhibit 10.16 to the Registration Statement on Form S-1 (No. 333-22429) filed February 27, 1997).
10.10	License and Joint Development Agreement, dated March 1, 1996, between NonInvasive-Monitoring Company, Inc., Altea Technologies, Inc. and SpectRx (incorporated by reference to Exhibit 10.19 to the Registration Statement on Form S-1 (No. 333-22429) filed February 27, 1997).
10.11*	Amendment to License and Joint Development Agreement, dated December 30, 2001, between NonInvasive-Monitoring Company, Inc., Altea Technologies, Inc. and SpectRx (incorporated by reference to Exhibit 10.17(B) to the Annual Report on Form 10-K, filed April 1, 2002).
10.12*	Development and License Agreement, dated July 13, 1999, between Roche Diagnostics Corporation and SpectRx (incorporated by reference to Exhibit 10.25(A) to the Quarterly Report on Form 10-Q for the quarter ended June 30, 1999, filed August 16, 1999, as amended).
10.13*	Supply Agreement, dated July 13, 1999, between Roche Diagnostics Corporation and SpectRx (incorporated by reference to Exhibit 10.25(B) to the Quarterly Report on Form 10-Q for the quarter ended June 30, 1999, filed August 16, 1999, as amended).
10.14	Consulting and Severance Agreement between SpectRx, Inc. and Mark A. Samuels, dated May 7, 2007 (incorporated by reference to Exhibit 10.1 to the Current Report of Form 8-K/A, filed June 5, 2007).
10.15	Consulting and Severance Agreement between SpectRx, Inc. and Dr. Walter Pavlicek, dated May 7, 2007 (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report of Form 8-K/A, filed June 5, 2007).
10.16	Severance Agreement between SpectRx, Inc. and William Arthur, III, dated May 7, 2007 (incorporated by reference to Exhibit 10.3 to the Registrant's Current Report of Form 8-K/A, filed June 5, 2007).
10.17	Asset Purchase Agreement by and among ICU Medical, Inc., SpectRx Inc., and Sterling Medivations, Inc., dated May 9, 2007(incorporated by reference to Exhibit 10.1 to the Quarterly Report of Form 10QSB, filed October 23, 2007).
16.1	Letter Re: Change in Certifying Accountants (incorporated by reference to Exhibit 99.1 to the Current Report on Form 8-K/A, filed November 6, 2007).
23.1(1)	Consent of Eisner LLP.
23.2(1)	Consent of UHY LLP.
31(1)	Rule 13a - 14(a) / 15d - 14(a) Certification.
32(1)	Section 1350 Certification.

* Confidential treatment granted for portions of these agreement.

(1) Filed herewith.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

GUIDED THERAPEUTICS, INC.
/s/ MARK L. FAUPEL

By:	Mark L. Faupel President and Chief Executive Officer
Date:	September 23, 2008

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the registration statements on Form S-8 (Registration Nos. 333-63758, 333-81326 and 333-128082) of our report dated April 19, 2007, with respect to the reclassification of Simple Choice business as discontinued operations, as described in Note 1, January 25, 2008, on our audit of the consolidated financial statements of Guided Therapeutics, Inc. and subsidiaries (formerly SpectRx, Inc. and subsidiaries) (the "Company"), as of December 31, 2006 and for the year then ended, which includes explanatory paragraphs regarding the Company's change in accounting principle for its method of accounting for stock-based compensation and the Company's ability to continue as a going concern, included in the 2007 annual report on Form 10-K.

/s/ Eisner LLP

New York, New York
September 23, 2008

EXHIBIT 23.2

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (No. 333-63758, 333-81326 and 333-128082) of

Guided Therapeutics, Inc. (formerly SpectRx, Inc. and subsidiaries), of our report dated July 8, 2008, except for Note 14, as to which the date is September 23, 2008, which report appears in the Annual Report on Form 10-K/A1 of Guided Therapeutics, Inc. (formerly SpectRx, Inc. and subsidiaries) as of December 31, 2007 and for the year then ended.

/s/ UHY LLP

September 23, 2008

Exhibit 31

Rule 13a-14(a)/15(d)-14(a) Certifications

I, Mark L. Faupel, certify that:

1. I have reviewed this annual report on Form 10-K of Guided Therapeutics, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant 's internal control over financial reporting.

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 23, 2008

/s/ Mark L. Faupel

Mark L. Faupel

President, Chief Executive Officer and
Acting Chief Financial Officer

Exhibit 32

SECTION 1350 CERTIFICATION

In connection with the Annual Report of Guided Therapeutics, Inc. (the "Company") on Form 10-K for the year ended December 31, 2007, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mark L. Faupel, President, Chief Executive Officer and Acting Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Sec 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: September 23, 2008

/s/ MARK L. FAUPEL

Name: Mark L. Faupel

Title: President, Chief Executive Officer and
Acting Chief Financial Officer