HEALTH DISCOVERY CORP
Form 10-Q
November 14, 2008

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

FORM 10-Q

x Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2008

o Transition report under Section 13 or 15(d) of the Exchange Act

For the transaction period from _____ to _____

Commission file number 333-62216

HEALTH DISCOVERY CORPORATION
(Exact name of small business issuer as specified in its charter)

Georgia	74-3002154
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

2 East Bryan Street, Suite #601
Savannah, Georgia 31401
(Address of principal executive offices)

912-443-1987
(Issuer's telephone number, including area code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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 the filing requirements for at least the past 90 days. Yes o No 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. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (check one):

Large Accelerated Filer o	Non-Accelerated Filer o
Accelerated Filer o	Smaller Reporting Company x

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section l2, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. Yes o No o

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 169,522,590 shares of common stock, no par value, were issued and outstanding as of November 13, 2008; 7,437,184 shares of Series A Preferred Stock with a stated value of $0.08 per share were issued and outstanding as of November 13, 2008.

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

HEALTH DISCOVERY CORPORATION
Balance Sheet
Assets

	September 30, 2008 (unaudited)	December 31, 2007
Current Assets		
Cash	$ 570,161	1,648,439
Accounts Receivable	112,500	112,500
Prepaid Expenses and Other Assets	42,007	33,829
Total Current Assets	724,668	1,794,768
Equipment, Less Accumulated Depreciation of $24,307 and $22,402	16,528	7,596
Other Assets		
Accounts Receivable – Long Term	-	112,500
Patents, Less Accumulated Amortization of $1,096,227 and $942,974	2,845,781	3,042,820
Total Assets	$ 3,586,977	4,957,684
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts Payable – Trade	$ 174,973	61,173
Accrued Liabilities	213,171	239,589
Deferred Revenue	62,708	62,708
Total Current Liabilities	450,852	363,470
Deferred Revenue – Long Term	406,684	453,715
Total Liabilities	857,536	817,185
Commitments		
Stockholders' Equity		
Series A Preferred Stock, Convertible, Stated Value of $0.08 per Share, 7,437,184 Shares Authorized, Issued and Outstanding	594,975	594,975
Common Stock, No Par Value, 300,000,000 Shares Authorized		

169,522,590 Shares Issued and Outstanding		15,654,941	15,390,609
Accumulated Deficit		(13,520,475)	(11,845,085)
Total Stockholders’ Equity		2,729,441	4,140,499
Total Liabilities and Stockholders' Equity	$	3,586,977	4,957,684

See accompanying notes to financial statements.

HEALTH DISCOVERY CORPORATION

Statements of Operations
(unaudited)

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Revenues:				
Licensing	$ 18,700	$ 17,343	$ 50,054	$ 39,010
Cost of Revenues:				
Internal Development	600	7,500	7,200	18,900
Gross Profit	18,100	9,843	42,854	20,110
Operating Expenses:				
Amortization	65,680	65,680	197,040	197,040
Professional and Consulting Fees	261,826	304,352	586,825	796,661
Compensation	208,710	218,396	602,550	540,106
Other General and Administrative Expenses	104,490	128,729	367,077	362,464
Total Operating Expenses	640,706	717,157	1,753,492	1,896,271
Loss From Operations	(622,606)	(707,314)	(1,710,638)	(1,876,161)
Other Income (Expense)				
Interest Income	6,459	4,926	35,983	14,902
Litigation Settlement	-	(42,000)	-	(42,000)
Gains on Restructuring of Accounts Payable	-	-	-	44,594
Interest Expense	(253)	(81,395)	(735)	(285,509)
Total Other Income (Expense)	6,206	(118,469)	35,248	(268,013)
Net Loss	$ (616,400)	$ (825,783)	$ (1,675,390)	$ (2,144,174)
Weighted Average Outstanding Shares	169,136,052	129,865,585	169,058,744	121,832,264
Loss Per Share	$ (.00)	$ (.01)	$ (.01)	$ (.02)

See accompanying notes to financial statements.

HEALTH DISCOVERY CORPORATION
Statements of Cash Flows
(unaudited)
For the Nine Months Ended September 30, 2008 and 2007

Cash Flows From Operating Activities	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Net Loss	$ (1,675,390)	$ (2,144,174)
Adjustments to Reconcile Net Loss to Net Cash Used by Operating Activities:		
Stock Issued in Settlement of Litigation	-	32,000
Stock-based Compensation	75,515	158,187
Services Exchanged for Warrants	188,817	226,669
Issuance of Warrants	-	33,756
Accretion of Debt Discount	-	192,361
Gains on Restructuring of Accounts Payable	-	(44,594)
Depreciation and Amortization	200,827	203,556
Refund of Deposit	-	25,759
Decrease in Interest Receivable	1,106	-
Decrease (Increase) in Accounts Receivable	112,500	(280,000)
(Decrease) Increase in Deferred Revenue	(47,031)	430,989
Increase in Prepaid Expenses and Other Assets	(9,284)	(8,198)
Decrease in Accounts Payable – Trade	(26,418)	(34,538)
Increase in Accrued Liabilities	113,800	185,518
Net Cash Used by Operating Activities	(1,065,558)	(1,022,709)
Cash Flows From Investing Activities:		
Purchase of Equipment	(12,720)	(998)
Investment in Joint Venture	-	(5,000)
Net Cash Used by Investing Activities	(12,720)	(5,998)
Cash Flows From Financing Activities:		
Proceeds from Sales of Common Stock, Net of Fees	-	2,436,540
Net Cash Provided by Financing Activities	-	2,436,540
Net (Decrease) Increase in Cash	(1,078,278)	1,407,833
Cash, at Beginning of Period	1,648,439	674,366
Cash, at End of Period	$ 570,161	$ 2,082,199
Stock-Based Investing and Financing Transactions:		
Common Stock, Series A Preferred Stock and Warrants Issued in Settlement of Promissory Note	-	1,893,774
Supplemental disclosures of cash flow information:		
Cash Paid for Interest	$ 735	$ 3,167

See accompanying notes to financial statements.

HEALTH DISCOVERY CORPORATION

Notes to Financial Statements

Note A - BASIS OF PRESENTATION

Health Discovery Corporation (the "Company") is a biotechnology-oriented company that has acquired certain patents and has patent pending applications for certain machine learning tools used for diagnostic and drug discovery. The Company licenses the use of its patent protected technology and utilizes such technology internally to develop diagnostic tests, drug monitoring tests and drug targets for therapeutic use, and sells or licenses such discoveries to diagnostic or pharmaceutical companies worldwide.

The accounting principles followed by the Company and the methods of applying these principles conform with accounting principles generally accepted in the United States of America (GAAP). In preparing financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts in the financial statements. Actual results could differ significantly from those estimates.

The interim financial statements included in this report are unaudited but reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the interim periods presented. All such adjustments are of a normal recurring nature. The results of operations for the period ended September 30, 2008 are not necessarily indicative of the results of a full year's operations and should be read in conjunction with the financial statements and footnotes included in the Company's annual report on Form 10-KSB for the year ended December 31, 2007.

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157, Fair Value Measurements, ("Statement No. 157"). This statement provides a single definition of fair value, a framework for measuring fair value, and expanded disclosures concerning fair value. Previously, different definitions of fair value were contained in various accounting pronouncements creating inconsistencies in measurement and disclosures. This pronouncement is effective for fiscal years beginning after November 15, 2007. Certain provisions of SFAS No. 157 are effective for the Company beginning in the first quarter of 2008. The adoption of SFAS No. 157 for financial assets and liabilities in the first quarter of 2008 did not have a material effect on the Company's results of operations and financial position.

In February 2007, FASB issued Statement of Financial Accounting Standards No. 159, "Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"), which permits entities to choose to measure many financial instruments and certain other items at fair value that were not currently required to be measured at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 was effective for the Company beginning in the first quarter of 2008. The adoption of SFAS No. 159 did not have a material impact in the Company's financial position.

In December 2007, FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), "Business Combinations" ("SFAS No. 141(R)"), which continues the evolution toward fair value reporting and significantly changes the accounting for acquisitions that close beginning in 2009, both at the acquisition date and in subsequent periods. SFAS No. 141(R) is not expected to have a material impact on the Company's financial statements.

HEALTH DISCOVERY CORPORATION

Notes to Financial Statements, continued

Note A - BASIS OF PRESENTATION, continued

In December 2007, FASB issued Statement of Financial Accounting Standards No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51" ("SFAS No. 160"), which requires companies to measure an acquisition of noncontrolling (minority) interest at fair value in the equity section of the acquiring entity's balance sheet. The objective of SFAS No. 160 is to improve the comparability and transparency of financial data as well as to help prevent manipulation of earnings. The changes introduced by the new standards are likely to affect the planning and execution, as well as the accounting and disclosure, of merger transactions. The effective date to adopt SFAS No. 160 for the Company is January 1, 2009. The adoption of SFAS No. 160 is not expected to have a material effect on its results of operations and financial position.

In March 2008, FASB issued Statement of Financial Accounting Standards No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" ("SFAS No 161"). SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133 with the intent to provide users of financial statements with an enhanced understanding of how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flow. The provisions of SFAS No. 161 are effective for the Company beginning in the first quarter of 2009. The adoption of SFAS No. 161 is not expected to have a material effect on the Company's results of operations and financial position.

Note B – REVENUE RECOGNITION

Revenue is generated through the sale or license of patented technology and processes and from services provided through development agreements. These arrangements are controlled by contracts that dictate responsibilities and payment terms. The Company recognizes revenues as earned over the duration of a license agreement or upon the sale of any owned patent once all contractual obligations have been fulfilled. Revenue is earned under development agreements in the period the services are performed.

Effective July 1, 2007, the Company entered into a patent license and settlement agreement with Ciphergen Biosystems, Inc. ("Ciphergen") in connection with the then pending litigation styled Health Discovery Corporation v. Ciphergen Biosystems, Inc. Case No. 07-00285-CRB before the United States District Court for the Northern District of California. The agreement provides Ciphergen a license to use certain patents. In consideration for entering into the agreement, Ciphergen agreed to pay the Company $600,000 over a two-year period. The revenue associated with this settlement was recorded net of $130,000 in contingently payable attorney fees as deferred revenue in the amount of $470,000 and will be recognized over the sixteen year remaining life of the subject patents.

Deferred revenue represents the unearned portion of payments received in advance for licensing agreements. The Company had total unearned revenue of $469,392 as of September 30, 2008. Unearned revenue of $62,708 is recorded as current and $406,684 is classified as long-term.

Note C - NET LOSS PER SHARE

Basic Earnings Per Share ("EPS") includes no dilution and is computed by dividing income or loss available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution of securities that could share in the earnings or losses of the entity. Due to the net loss in all periods

presented, the calculation of diluted per share amounts would create an anti-dilutive result and therefore is not presented.

Note D - STOCK-BASED EXPENSE

Stock-based expense included in our net loss for the three months and nine months ended September 30, 2008 consisted of $66,253 and $264,332 respectively in compensatory warrants and options for professional consulting services, directors fees and compensation. Stock-based expense included in our net loss for the three months and nine months ended September 30, 2007 was $180,858 and $450,612 respectively.

HEALTH DISCOVERY CORPORATION

Notes to Financial Statements, continued

Note D - STOCK-BASED EXPENSE, continued

As of September 30, 2007 and September 30, 2008, there was approximately $528,558 and $595,141, respectively, of unrecognized cost related to stock option and warrant grants. The cost is to be recognized over the remaining vesting periods of approximately 2.0 years.

The following schedule summarizes stock option activity for the nine months ended September 30, 2008 and the twelve months ended December 31, 2007:

	Option Shares	Weighted Average Exercise Price
Outstanding, January 1, 2007	3,500,000	$ 0.11
Granted	-	-
Exercised	-	-
Forfeited	-	-
Outstanding, December 31, 2007	3,500,000	$ 0.11
Granted	7,250,000	$ 0.08
Exercised	-	-
Forfeited	(1,500,000)	$ (0.11)
Outstanding, September 30, 2008	9,250,000	$ 0.09

The weighted average remaining life of the outstanding options at September 30, 2008 is 9.2 years.

During the third quarter, 1,250,000 options with an exercise price of $0.08 were granted to a former director who continues to provide services to the Company. Full vesting occurs over two years. The aggregate computed value of these options is $74,693 and the amount will be charged as expense over the vesting period.

On August 15, 2008, the Chief Executive Officer of the Company was granted 6,000,000 options with an exercise price of $0.08 per share. The options vest over two years and are subject to performance criteria related to share price and other metrics. The estimated value of these options as computed using the Black-Scholes Pricing Model was $0.0738 per share or $443,000. This amount will be recorded as compensation over the two-year vesting period.

In July 2008, 1,500,000 options expired un-exercised due to the departure of the Company's former Executive Vice President.

There were 2,250,000 options exercisable at September 30, 2008. The exercisable options have a weighted average exercise price of $0.09 and a weighted average remaining life of 8.6 years. The aggregate intrinsic value of options outstanding is zero at September 30, 2008.

HEALTH DISCOVERY CORPORATION

Notes to Financial Statements, continued

Note D - STOCK-BASED EXPENSE, continued

Information about warrants outstanding at September 30, 2008 is summarized below:

Number of warrants issued	Nine Months Ended September 30 2008	Twelve Months Ended December 31 2007
Outstanding beginning of period	159,099,644	68,796,250
Issued	1,500,000	122,773,394
Exercised	-	(100,000)
Expired or forfeited	(3,050,000)	(32,370,000)
Outstanding end of the period	157,549,644	159,099,644

Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life (years)	Number Exercisable	Weighted Average Remaining Contractual Life (years) of Exercisable Warrants
$0.01	200,000	0.3	200,000	0.3
$0.08	2,050,000	5.1	841,667	2.0
$0.10	1,425,750	0.5	1,425,750	0.5
$0.11	1,500,000	0.9	1,500,000	0.9
$0.12	150,000	0.3	150,000	0.3
$0.13	5,000,000	1.5	5,000,000	1.5
$0.14	52,138,822	1.9	52,138,822	1.9
$0.15	1,000,000	0.3	1,000,000	0.3
$0.16	10,000,000	1.0	10,000,000	1.0
$0.19	51,538,822	2.0	51,538,822	2.0
$0.24	32,546,250	0.3	32,546,250	0.3
Total	157,549,644		156,341,311	

In June 2008, a warrant to purchase 1,500,000 shares of Company common stock at an exercise price of $0.08, vesting over three years and expiring in six years, was issued by the Company to a new director. The value of $85,200 will be charged as directors' fees over the vesting period.

During the third quarter of 2008, 1,000,000 warrants previously issued to service providers expired unexercised. The Company issued an option to purchase 1,250,000 shares of the Company's common stock to a former director of the Company in connection with his performance of consulting services.

During the first nine months of 2008, a total of 3,050,000 warrants were forfeited or expired unexercised.

In the first quarter of 2008, the Company fully vested a 1,500,000 warrant grant for a retiring director by accelerating the vesting of 375,000 warrants exercisable at $0.13. A charge of $44,438 was recorded as directors' fees.

HEALTH DISCOVERY CORPORATION

Notes to Financial Statements, continued

Note D - STOCK-BASED EXPENSE, continued

On February 1, 2007, the Company issued in the aggregate 15,235,000 warrants to purchase common stock of the Company (the "Warrants") to certain institutional investors and individual accredited investors. The Warrants vested immediately and had an exercise price of $0.35 per share. The Warrants expired on November 1, 2007. On February 1, 2007, an equal number of warrants issued to the same institutional and individual investors and with substantially similar terms expired. The fair value of these warrants was approximately $33,755 and they were recorded as expense on the issue date.

Also on February 1, 2007, the Company issued 500,000 warrants to consultants, which vested immediately, and have an exercise price of $0.14. Additionally, the Company issued 100,000 warrants to a consultant, which vested over a period of ten months, and have an exercise price of $0.14. Together, these warrants were valued at $49,068 and expire on December 31, 2009. The expense was recorded over the vesting period.

During the third quarter of 2007, the Company issued 60,750 warrants, which expire on December 31, 2008, to a vendor as payment for professional services rendered. These warrants had an exercise price of $0.10 and were fully vested upon issuance. The fair value of $1,719 was recorded as expense. The Company also issued 300,000 warrants with an exercise price of $0.18 to a former employee as part of a termination agreement. These warrants, which expire after three years, vested immediately and had a fair value of $13,869. This amount was recorded as compensation expense. Two new directors were each awarded 1,500,000 warrants which vest over three years and expire in six years. These warrants have an exercise price of $0.08 and had an aggregate fair market value of $197,374. Upon the resignation of one director in June 2007, 1,500,000 of these warrants were forfeited. During the third quarter of 2008, 1,250,000 remaining unvested shares of a 1,500,000 share warrant were forfeited due to the resignation of a director. The non-forfeited warrants will be charged as directors' fees over the vesting period.

The Company also issued warrants in connection with the sale of common stock effective September 7, 2007. Each purchaser of common stock received one warrant exercisable at $0.14 (the "Tranche 1 Warrants") and one warrant exercisable at $0.19 (the "Tranche 2 Warrants") for each share of common stock purchased or converted from debt. All these warrants vested immediately, expire three years from the date of issuance, and are subject to call rights based upon the trading value of the Company's stock. With respect to the Tranche 1 Warrants, if the Company's stock trades for an amount in excess of $0.17 for thirty (30) consecutive days, then 50% of the warrants may be called by the Company. With respect to the Tranche 2 Warrants, if the Company's stock trades for an amount in excess of $0.24 for thirty (30) consecutive days, then 50% of the warrants may be called by the Company. The Tranche 1 Warrants, if exercised, may result in the issuance of up to 51,538,832 shares of the Company's common stock, at an exercise price of $0.14 per share, and the Tranche 2 Warrants, if exercised, may result in the issuance of up to 51,538,832 shares of Company common stock at an exercise price of $0.19 per share. These warrants were valued at $0.005 each resulting in $515,388 of common stock proceeds being allocated to the fair value of the warrants and credited to equity.

Note E – GAIN ON RESTRUCTURING OF ACCOUNTS PAYABLE

On March 1, 2007, the Company recorded a gain on accounts payable restructuring of $44,594 pursuant to the agreement made in the third quarter of 2006 deferring some payments until certain conditions were met or eliminating the liability if these conditions did not occur.

Note F - PATENTS

The Company has acquired a group of patents related to biotechnology and certain machine learning tools used for diagnostic and drug discovery. Legal costs associated with patent acquisitions and the application process for new patents are also capitalized as patent assets. The Company has recorded as other assets $2,845,781 in patents and patent related costs, net of $1,096,227 in accumulated amortization, at September 30, 2008.

Amortization charged to operations for the three months and nine months ended September 30, 2008 and 2007 was $65,680 and $197,040, respectively, for both years. The weighted average amortization period for patents is 14 years. Estimated amortization expense for the next five years is $262,720 per year.

HEALTH DISCOVERY CORPORATION

Notes to Financial Statements, continued

Note G – INVESTMENTS

On March 27, 2007, the Company and an investment partner formed SVM Capital LLC as an equity investment for purposes of utilizing SVMs as a quantitative investment management technique. The Company owns 45% of the membership interest and has significant influence with the operation of the entity but it not considered the primary beneficiary. Accordingly, the investment is presented using the equity method of accounting. The Company's initial investment was $5,000. Equity in the loss of SVM Capital LLC for 2007 was $5,000. The resultant net value was zero at June 30, 2008. The Company has no contractual obligation to fund this venture.

As of August 22, 2008, the Company entered into an operating agreement with the principals of Smart Personalized Medicine, LLC ("SPM") wherein the Company received at 15% membership interest in return for executing a licensing agreement with SPM. No cash investment has been made, and no value for this investment has been recorded.

Note H – STOCKHOLDERS' EQUITY

In January 2007, the Company issued 100,000 shares of stock for warrants exercised at $0.01 each. Proceeds of $1,000 were recorded in capital stock. In September 2008, the Company issued 515,384 shares of Company common stock to certain investors pursuant to the terms of the Securities Purchase Agreement dated as of August 15, 2007.

Note I – GOING CONCERN

The accompanying financial statements have been prepared in conformity with principles of accounting applicable to a going concern, which contemplates the realization of assets and the liquidation of liabilities in the normal course of business. Limited revenue has been earned since inception, and the Company has not yet generated sufficient working capital to support its operations. The Company's ability to continue as a going concern is dependent, among other things, on its ability to control certain costs and obtain new contracts to eventually attain a profitable level of operations.

The Company is licensing the technology underlying several of its patents and providing supporting services related to the application of such technology that is resulting in ongoing revenue. The Company raised $2.55 million in cash through a common stock offering and additionally converted $2.2 million of secured debt to equity in the third quarter of 2007. The Company's plan to have sufficient cash to support operations is comprised of generating revenue through licensing its significant patent portfolio, providing services related to those patents, and obtaining additional equity or debt financing. The Company has been and continues to be in meaningful discussions with a variety of parties, which if successful, may result in significant revenue, as further described in Item 2 below. In the meantime, the Company maintains a vigilant cash conservation program.

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

Corporate Overview

Our Company is a pattern recognition company that uses advanced mathematical techniques to analyze large amounts of data to uncover patterns that might otherwise be undetectable. Our Company operates primarily in the emerging field of molecular diagnostics where such tools are critical to scientific discovery. Our primary business consists of licensing our intellectual property and working with prospective customers on the development of varied products that utilize pattern recognition tools. We also endeavor to develop our own product line of newly discovered biomarker-based diagnostic tests that include human genes and genetic variations, as well as gene, protein, and metabolite expression differences and image analysis. In drug discovery, biomarkers can help elicit disease targets and pathways and validate mechanisms of drug action. They may also be pharmacodynamic indicators of drug activity, response and toxicity for use in clinical development.

We have partnered and intend to continue partnering with clinical laboratories to commercialize our clinical diagnostic tests and to provide pharmaceutical and diagnostic companies with all aspects of all phases of diagnostic and drug discovery, from expert assessment of the clinical dilemma through proper selection and procurement of high quality specimens. We will then apply our proprietary analytical evaluation methods and state-of-the-art computational analysis to derive relevant and accurate clinical data, producing accurate biomarker and pathway discoveries, resulting in patent protection of our biomarker discoveries for future development.

Our business is based on the belief that in order to discover the most clinically relevant biomarkers, the computational component must begin at the inception of the clinical dilemma to be solved. This process includes several critical levels of decision-making - all of which are part of our business strategy. We intend to produce more relevant and predictable biomarkers for drug discovery so that new and better medicines and diagnostic markers can be developed for patients worldwide.

Operational Activities

The Company actively markets its technology and related developmental expertise to several prospects in the healthcare field, including some of the world's largest corporations in the pharmaceutical, biotech, and life sciences industries. Given the scope of some of these prospects, the sales cycle can be quite long, but management believes that these marketing efforts will produce favorable results.

In August 2008, we announced that we entered into a licensing agreement with Smart Personalized Medicine, LLC, a company founded by our former director, Dr. Richard Caruso. Under the terms of this agreement, we will work to develop a superior breast cancer prognostic test using our SVM technology in collaboration with MD Anderson Cancer Center. In exchange for a license to use our SVM technology, we will receive a 15% equity position in Smart Personalized Medicine, LLC (which will remain undiluted until there is at least $5 million in investment from investors in Smart Personalized Medicine, LLC) and a per test royalty up to 7.5% based on net proceeds received from the sale of the new breast cancer prognostic test.

In August 2008, we announced the signing of an agreement with Patent Profit International ("PPI"), a Silicon Valley-based patent brokerage firm, with the goal of marketing our patent portfolio and exclusive rights to SVM techniques and applications beyond biomarker discovery and the healthcare field, to prospective buyers/licensees in a wide range of technologies, including, but not limited to, information technology such as Internet browsers and search engines, digital photography, spam mail detection, oil exploration, homeland security, and the automotive industry. As a requirement of any potential sale of the patent portfolio, HDC expects to retain a royalty-free, worldwide, exclusive license, with the right to grant sublicenses, in the entire field of healthcare to enable our continued research, development, licensing and commercialization activities in diagnostic and prognostic areas such

as prostate cancer, ovarian cancer, breast cancer, endometrial cancer, colon cancer, leukemia and other healthcare arenas. The Company anticipates that PPI will initiate the marketing of our patent portfolio in the fourth quarter of 2008.

In August 2008, we announced that the U.S. Patent and Trademark Office granted a patent to us covering the use of SVMs in computer-aided image analysis of digitized microscopic images of medical specimens. This patent focuses on a method and computer system for analyzing medical images generated during microscopic evaluation of cytology specimens and tissue samples. SVM-aided image analysis using this patented method could permit automated and rapid analysis of a series of sample images that are typically examined visually by a technologist or pathologist, greatly increasing the sensitivity and accuracy of tests.

In July 2008, the Company and DCL entered into a development and license agreement for the collaborative development and commercialization of SVM-based computer assisted diagnostic tests for the independent detection of ovarian, cervical and endometrial cancers, which expands the scope of the joint development efforts. Pursuant to the development and license agreement, HDC will own any developed intellectual property and DCL will have a sole use license relating to applications and new mathematical tools developed during the course of the development and license agreement. Images and interpretative data from this new SVM-based system may now be transmitted electronically, thus allowing remote review and collaborative interpretation. Dr. Hanbury, our new director, is currently President, CEO and a shareholder of DCL.

On July 31, 2007, we entered into an alliance and licensing agreement with Clarient, Inc. for development of a new molecular diagnostic test for prostate cancer based on our discovered prostate cancer biomarker signature. Under the terms of that agreement, Clarient obtained an exclusive license to the biomarker signature in exchange for HDC's 30% royalty interest from all reimbursements of the test once commercialized. We and Clarient have successfully completed all phases of the clinical trial process with the hope of achieving the statistical significance necessary to validate the ability to commercialize a test. Results from both the Phase I, Phase II and Phase III double-blinded clinical validation studies now completed at Clarient demonstrated a very high success rate for identifying the presence of Grade 3 or higher prostate cancer cells (clinically significant cancer), as well as normal BPH (benign prostatic hyperplasia) cells. Combining all of the patients from all three phases of the clinical trials, the new gene-based molecular diagnostic test achieved a Sensitivity rate of 90% for correctly identifying the presence of Grade 3 or higher prostate cancer cells, a Specificity rate of 97% for correctly identifying normal prostate cells and a Specificity rate of 90% for identifying BPH cells, representing an overall test accuracy of 93%. With the completion of the clinical trial, HDC's new gene-based molecular diagnostic test is now ready for commercialization to be used by physicians on their patients at risk of having prostate cancer. The new prostate cancer test will be performed at Clarient's Clinical Laboratory in Aliso Viejo, CA. HDC will receive 30% royalty on each test performed.

The U.S. Patent and Trademark Office issued one new patent to the Company in April 2008, which covers the use of FGM technology for visualization of data patterns. In May, 2008, the U.S. Patent and Trademark Office issued two new patents to the Company. One of the patents claims a method for analysis of any type of data that has a structure. The second patent covers additional feature selection techniques that can be used to successfully identify the most important pieces of information needed to solve complex pattern-recognition problems. The U.S. Patent and Trademark Office issued one new patent to the Company in June 2008, which covers the use of SVMs for computer-aided analysis of medical images, with particular applications in cytology and pathology. Also in June 2008, the Company was issued a patent in Japan, which covers recursive feature elimination (RFE) using SVMs for selection and ranking of the most important features within large datasets. With the issuance of these patents, the Company now holds the exclusive rights to 33 issued U.S. and foreign patents covering uses of SVM and FGM technology for discovery of knowledge from large data sets.

In September 2008, we received royalty proceeds related to our licensing agreement with Bruker Daltonics, which was originally announced in August, 2006. The royalties relate to Bruker Daltonics' sales of its ClinProToolsTM clinical proteomics product line for its mass spectrometers, which contains HDC's SVM technology. Bruker launched its ClinProToolsTM at approximately the same time as the license with HDC. While this royalty was relatively small, it represents additional royalty payments from this relationship and offers the opportunity of future royalties for the life of the patents related to future sales of the Bruker product.

Management believes that our research agreement with a leading biotech company to develop an SVM-based diagnostic test to help interpret flow cell cytometry data for a particular medical condition has resulted in a successful proof of concept. These findings were presented during the first quarter of 2008 and the due diligence process has accelerated to confirm our findings for that particular condition and determine other applications within flow cytometry.

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We have advanced discussions with two large international healthcare companies with respect to diagnostic imaging opportunities. Our objective is licensing and product development using SVMs and FGMs in diagnostic radiology, including mammography, PET scans, CT scans, MRI and other radiological images. In addition, given the scope of these two prospects, we believe we can demonstrate the computational power of our SVM technology analyzing combined data from imaging, proteomics, and genomics. We own a number of SVM and FGM patents in this field that we believe are very important.

Negotiations with a large European pharmaceutical company to develop a companion diagnostic test using our discovered biomarkers as surrogates in the last phase of a clinical trial for its new drug to treat BPH (enlarged prostate) remain delayed due to the prospect's post-acquisition integration issues. Based on the prospect's representations, we hope that discussions regarding this prospective opportunity will resume sometime in 2009. We have also initiated discussions to bring this opportunity to other pharmaceutical companies with new BPH drugs in clinical development.

We have advanced our dialogue with several other important industry players in the healthcare field and, in certain situations, related to the field of pathology imaging and genomic, including a proposed project with one of the world's largest diagnostic/pharmaceutical companies, a marketing arrangement with one of the world's largest generic drug manufacturers, and other prospective partnership opportunities with additional companies and research institutions. We also continue to pursue development opportunities with our existing licensing customers.

In January 2007, SVM Capital, LLC was formed as a joint venture between HDC and Atlantic Alpha Strategies, LLC ("Atlantic Alpha") to explore and exploit the potential applicability of our SVM technology to quantitative investment management techniques. Atlantic Alpha has over thirty years of experience in commodity and futures trading. SVM Capital has made significant progress since the formation of the joint venture. The SVM technology is now working well with dynamic time series for S&P data accumulated over the past fifty-eight years. The latest SVM-derived models generated by SVM Capital have successfully outperformed the static buy-and-hold model both in increased returns as well as in reduced risk. Once the stability of these models is confirmed, SVM Capital intends to apply the models to a wide range of financial asset classes such as interest rates, currencies, metals and petroleum products. The joint venture partners plan to apply the investment model either in a single fund or a fund of funds. SVM Capital will charge a management fee and a performance fee for managing client assets. Depending on the level of its success, this venture can be profitable given its reliance on cost effective use of computer technology and ready access to efficient trading platforms. The initial investment was $5,000 and was subsequently written off as the Company recorded its share of the losses of this venture. The Company has no further funding commitment for this venture. In November 2008, SVM Capital's system began trading live with a full beta test.

Since December 2005, the total value of licenses and development contracts signed is approximately $1,362,000.

While we have a number of negotiations in process with potential licensing partners, there is a possibility that we will be unable to reach agreement with any party, that the negotiations continue but are not finalized, or that those that may be finalized do not provide the economic return that we expect.

Three Months Ended September 30, 2008 Compared with Three Months Ended September 30, 2007

Revenue

For the three months ended September 30, 2008, revenue was $18,700 compared with $17,343 for the three months ended September 30, 2007. Revenue is recognized for licensing and development fees over the period earned. This revenue is primarily related to the amortization of deferred revenue resulting from prior licensing agreements.

Cost of Revenues and Gross Margin

Internal development costs of $600 were recorded as cost of sales for the third quarter 2008 compared with $7500 for the third quarter of 2007. Cost of revenues includes all direct costs, primarily wages and research fees, associated with the acquisition and development of patents and processes sold. All direct costs, including some professional fees associated with licensing negotiations, are also included in cost of revenues.

Operating and Other Expenses

Amortization expense was $65,680 for both the third quarter of 2008 and 2007. Amortization expense relates primarily to the costs associated with filing patent application and acquiring rights to the patents.

Professional and consulting fees totaled $261,826 for the third quarter of 2008 compared with $304,352 for the third quarter of 2007. The decrease is due to an unusually high legal fees amount last year.

Compensation of $208,710 for the third quarter of 2008 was lower than the $218,396 reported for the third quarter of 2007. Compensation decreased because of the departure of an employee in 2008. Additionally, a $50,000 bonus was recorded in the third quarter of 2008. A $45,000 settlement with a former employee was recorded in the third quarter of 2007.

Other general and administrative expenses decreased to $104,490 for the third quarter of 2008 compared to $128,729 for the third quarter of 2007. The decrease was due to a reduction in the charge for directors warrants.

Loss from Operations

The loss from operations for the third quarter of 2008 was $622,606 compared to $707,314 for the third quarter of 2007. This decreased loss was due to decreased costs as discussed previously.

Other Income and Expense

Interest income was $6,459 for the third quarter of 2008 compared to $4,926 in 2007. Interest income increased because the Company had more cash on hand to invest throughout the third quarter of 2008.

Interest expense was $253 in the third quarter of 2008 compared with $81,395 in the third quarter of 2007. This decrease reflects the elimination of debt in the fourth quarter of 2007.

Net Loss

The net loss for the third quarter of 2008 was $616,400 compared to $825,783 for the third quarter of 2007. The decreased loss was due to the decrease in expenses as previously described.

Net loss per share was $0.00 and $0.01 for the third quarter of 2008 and 2007 respectively.

Nine Months Ended September 30, 2008 Compared with Nine Months Ended September 30, 2007

Revenue

For the nine months ended September 30, 2008, revenue was $50,054 compared with $39,010 for the nine months ended September 30, 2007. Revenue is recognized for licensing and development fees over the period earned.

Cost of Revenues and Gross Margin

Internal development costs of $7,200 were recorded as cost of sales for the nine months ended September 30, 2008 compared with $18,900 for the comparable 2007 period. Cost of revenues includes all direct costs, primarily wages and research fees, associated with the acquisition and development of patents and processes sold. All direct costs, including some professional fees associated with licensing negotiations, are also included in cost of revenues.

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Operating and Other Expenses

Amortization expense was $197,040 for both the nine months ended September 30, 2008 and 2007. Amortization expense relates primarily to the costs associated with filing patent application and acquiring rights to the patents.

Professional and consulting fees totaled $586,825 for the nine months ended September 30, 2008 compared with $796,661 for the nine months ended September 30, 2007. The decrease is due to lower fees, primarily legal, incurred for 2008.

Compensation of $602,550 for the nine months ended September 30, 2008 was higher than the $540,106 reported for the comparable 2007 period. Compensation increased because of the $50,000 bonus paid to the Chief Executive Officer and increased charges for medical insurance.

Other general and administrative expenses increased slightly to $367,077 for the nine months ended September 30, 2008 compared to $362,464 for the nine months ended September 30, 2007.

Loss from Operations

The loss from operations for the nine months ended September 30, 2008 was $1,710,638 compared to $1,876,161 for the comparable 2007 period. This decreased loss was due to decreased costs as discussed previously.

Other Income and Expense

Interest income was $35,983 for the nine months ended September 30, 2008 compared to $14,902 for the nine months ended September 30, 2007. Interest income increased because the Company had more cash on hand to invest throughout 2008.

Interest expense was $735 in the nine months ended September 30, 2008 compared with $285,509 in the nine months ended September 30, 2007. This decrease reflects the elimination of debt in the fourth quarter of 2007.

Net Loss

The net loss for the nine months ended September 30, 2008 was $1,675,390 compared to $2,144,174 for the nine months ended September 30, 2007. The decreased loss was due to the smaller net loss from operations and the decrease in interest expense.

Net loss per share was $0.01 and $0.02 for the nine months ended September 30, 2008 and 2007 respectively.

Liquidity and Capital Resources

At September 30, 2008, the Company had $570,161 in available cash. Cash used by operating activities year to date was $1,065,558. This was due primarily to the net loss of $1,675,390; however, net non-cash charges and adjustments of $609,832 favorably impacted the computation of the net cash used. Cash used by investment activities was $12,720 due to the acquisition of fixed assets. Net cash provided by financing activities was zero.

The following table summarizes the due dates of our contractual obligations.

	Total	1 Year Or Less	More than 1 Year
Deferred Compensation	$ 57,500	$ 57,500	$ -

Office Lease	37,182	21,246	15,936
Total	$ 94,682	$ 78,746	$ 15,936

The Company has relied primarily on equity funding plus debt financing for liquidity. The Company produced sales, licensing, and developmental revenue starting in late 2005 and must continue to do so in order to generate sufficient cash to continue operations. The Company's plan to have sufficient cash to support operations is comprised of generating revenue through licensing its significant patent portfolio, providing services related to those patents, and obtaining additional equity or debt financing. The Company has been and continues to be in meaningful discussions with a variety of parties, which if successful, may result in significant revenue, as further described above. In the meantime, the Company maintains a vigilant cash conservation program.

Subsequent Events

In October 2008, the U.S. Patent and Trademark Office issued the Company's newest patent covering a data mining platform for collecting and analyzing bioinformatics data using SVMs. This new patent addresses methods for taking gene expression data from different sources, such as experimental results and published literature, and using various feature ranking algorithms for classifying the combined information to generate ranked lists of genetic data. The ranked lists include biomarkers useful for diagnosis, screening and monitoring of diseases or conditions.

On November 6, 2008 the Company announced that the RT-PCR assay for the four genes comprising the Company's recently commercialized gene-based molecular diagnostic test for prostate cancer, which is currently available at Clarient's Clinical Laboratory, can be successfully used in urine samples for gene testing. The study, completed in collaboration with MD Anderson Cancer Center, demonstrated that the gene expression of all four genes comprising the molecular signature for clinically significant prostate cancer could be detected in urine samples spiked with as few as 50 prostate cancer cells. Based on these initial findings, the Company intends to begin clinical testing to confirm these successful findings in a larger clinical trial.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements that provide financing, liquidity, market or credit risk support or involve leasing, hedging or research and development services for our business or other similar arrangements that may expose us to liability that is not expressly reflected in the financial statements.

Forward-Looking Statements

This Report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 12E of the Securities Exchange Act of 1934, including or related to our future results, certain projections and business trends. Assumptions relating to forward-looking statements involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. When used in this Report, the words "estimate," "project," "intend," "believe," "expect" and similar expressions are intended to ident forward-looking statements. Although we believe that assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate, and we may not realize the results contemplated by the forward-looking statement. Management decisions are subjective in many respects and susceptible to interpretations and periodic revisions based on actual experience and business developments, the impact of which may cause us to alter our business strategy or capital expenditure plans that may, in turn, affect our results of operations. In light of the significant uncertainties inherent in the forward-looking information included in this Report, you should not regard the inclusion of such information as our representation that we will achieve any strategy, objective or other plans. The forward-looking statements contained in this Report speak only as of the date of this Report as stated on the front cover, and we have no obligation to update publicly or revise any of these forward-looking statements. These and other statements which are not historical facts are based largely on management's current expectations and assumptions and are subject to a number of risks and uncertainties that could cause actual results to differ materially from those contemplated by such forward-looking statements. These risks and uncertainties include, among others, the

failure to successfully develop a profitable business, delays in identifying customers, and the inability to retain a significant number of customers, as well as the risks and uncertainties described in “Risk Factors” section to our Annual Report for the fiscal year ended December 31, 2007, filed on March 31, 2008.

Item 4T. Controls and Procedures.

As of September 30, 2008 (the “Evaluation Date”), our Chief Executive Officer, who is also serving as our Principal Financial Officer, carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based upon this evaluation, our Chief Executive Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the reports that are filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified by the Securities and Exchange Commission’s rules and forms and that our disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management including our Chief Executive Officer and Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that the Company's disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the company to disclose material information otherwise required to be set forth in the Company's periodic reports.

The Company's management is also responsible for establishing and maintaining adequate internal control over financial reporting 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. As of the Evaluation Date, no changes in the Company's internal control over financial reporting occurred that have materially affected or are reasonably likely to materially affect, the Company's internal control over financial reporting.

On June 30, 2008, our Principal Financial Officer resigned. The Company is undertaking a search process to identify a suitable replacement. Until we hire a replacement, our Chief Executive Officer will serve as our Principal Financial Officer.

PART II—OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the third quarter of 2008, the Company issued an option to purchase 1,250,000 shares of the Company's common stock to a former director of the Company in connection with his performance of consulting services. The options will vest over two years, so long as the recipient continues to serve the Company as an advisor, and expire in five years. These warrants have an exercise price of $0.08.

Also during the third quarter of 2008, the Company's Chief Executive Officer was granted an option to purchase an aggregate of 6,000,000 shares of the Company's common stock at an exercise price of $0.08. The options vest over a two year period, assuming a minimum share price, and with respect to a portion of the options, the Company attaining certain performance metrics, as more fully described in the Option Award filed as Exhibit 10.3 to the Company's Form 8-K filed August 18, 2008.

In September 2008, the Company issued 515,384 shares of Company common stock to certain investors for no additional consideration pursuant to the terms of the Securities Purchase Agreement dated as of August 15, 2007.

The shares and the options described herein were offered and sold in reliance upon exemptions from registration pursuant to Section 4(2) under the Securities Act of 1933, as amended, and Regulation D promulgated thereunder. There were no underwriters in connection with either of these transactions, and there were no underwriting discounts or commissions.

Item 5. Other Information.

On September 24, 2008, our previously-filed registration statement on Form S-1, which was required by the terms of the private placement we completed in September, 2007 (the "Private Placement") and first disclosed on Form 8-K, dated September 10, 2007, was declared effective. The registration statement covers 35,274,934 shares of our common stock if warrants with an exercise price of $0.14 per share are exercised and 35,274,934 shares of our common stock if warrants with an exercise price of $0.19 per share are exercised. The registration statement also covers 352,746 shares of our common stock that were issued to the investors in September pursuant to the terms of the Private Placement. All of the warrants are currently outstanding and were issued in the Private Placement. We will not receive any proceeds from any shares ultimately sold pursuant to the registration statement. However, we will receive cash upon the exercise of the warrants of $11,640,728.22 if all of the warrants are exercised. The exercise price of the warrants is fixed, subject to adjustments for stock splits or combinations.

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Item 6. Exhibits.

The following exhibits are attached hereto or incorporated by reference herein (numbered to correspond to Item 601(a) of Regulation S-K, as promulgated by the Securities and Exchange Commission) and are filed as part of this Form 10-Q:

10.1 Amendment to Stock Purchase Warrant with Dr. Richard Caruso. Registrant incorporates by reference Exhibit 10.1 to Form 8-K filed August 18, 2008.

10.2 Employment Agreement between the Company and Stephen D. Barnhill, M.D., dated August 15, 2008. Registrant incorporates by reference Exhibit 10.2 to Form 8-K filed August 18, 2008.

10.3 Option Award to Stephen D. Barnhill, M.D., dated August 15, 2008. Registrant incorporates by reference Exhibit 10.3 to Form 8-K filed August 18, 2008.

10.4 License and Development Agreement by and between the Company and DCL Medical Laboratories, LLC dated July 14, 2008. Registrant incorporates by reference Exhibit 10.17 to Registration Statement on Form S-1 filed September 19, 2008.

31.1 Rule 13a-14(a)/15(d)-14(a) Certifications of Chief Executive Officer and Principal Financial Officer.

32.1 Section 1350 Certification of Chief Executive Officer and Principal Financial Officer.

SIGNATURES

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

Health Discovery Corporation
Registrant

Date: November 14, 2008	By:	/s/ Stephen D. Barnhill Printed Name: Stephen D. Barnhill M.D. Title: Chief Executive Officer and Principal Financial Officer