

BSD MEDICAL CORP  
Form 10-Q  
July 09, 2012

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

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended May 31, 2012

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

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

Commission File No. 001-32526

BSD Medical Corporation  
(Exact Name of Registrant as Specified in Its Charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

75-1590407  
(I.R.S. Employer  
Identification No.)

2188 West 2200 South  
Salt Lake City, Utah 84119  
(Address of principal executive offices, including zip code)

(801) 972-5555  
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

As of July 9, 2012, there were 29,753,191 shares of the Registrant's common stock, \$0.001 par value per share, outstanding.

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BSD MEDICAL CORPORATION  
FORM 10-Q

FOR THE QUARTER ENDED MAY 31, 2012

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

BSD MEDICAL CORPORATION  
Condensed Balance Sheets  
(Unaudited)

ASSETS	May 31, 2012	August 31, 2011
<b>Current assets:</b>		
Cash and cash equivalents	\$12,736,998	\$17,135,968
Accounts receivable, net of allowance for doubtful accounts of \$20,000	248,626	397,264
Related party trade accounts receivable	14,757	408,323
Inventories, net	2,318,260	2,406,214
Other current assets	151,363	121,148
<b>Total current assets</b>	<b>15,470,004</b>	<b>20,468,917</b>
Property and equipment, net	1,444,712	1,445,897
Patents, net	9,297	25,092
	<b>\$16,924,013</b>	<b>\$21,939,906</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable	\$237,339	\$301,936
Accrued liabilities	199,828	332,004
Deferred revenue – current portion	99,534	42,214
<b>Total current liabilities</b>	<b>536,701</b>	<b>676,154</b>
Deferred revenue – net of current portion	132,521	192,158
<b>Total liabilities</b>	<b>669,222</b>	<b>868,312</b>
<b>Commitments and contingencies</b>		
<b>Stockholders' equity:</b>		
Preferred stock, \$.001 par value; 10,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock, \$.001 par value; 80,000,000 shares authorized; 29,753,191 and 29,686,154 shares issued, respectively	29,778	29,686
Additional paid-in capital	51,529,691	50,458,729
Treasury stock, 24,331 shares at cost	(234 )	(234 )
Accumulated deficit	(35,304,444)	(29,416,587)
<b>Total stockholders' equity</b>	<b>16,254,791</b>	<b>21,071,594</b>
	<b>\$16,924,013</b>	<b>\$21,939,906</b>

See accompanying notes to condensed financial statements



**BSD MEDICAL CORPORATION**  
**Condensed Statements of Operations and Comprehensive Loss**  
(Unaudited)

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2012	2011	2012	2011
<b>Revenues:</b>				
Sales	\$ 611,730	\$ 647,732	\$ 1,165,655	\$ 1,506,904
Sales to related parties	13,757	1,017,845	315,163	1,058,597
Equipment rental	25,900	9,900	101,450	61,400
<b>Total revenues</b>	<b>651,387</b>	<b>1,675,477</b>	<b>1,582,268</b>	<b>2,626,901</b>
<b>Cost of Revenues:</b>				
Cost of sales	435,656	90,064	934,070	808,732
Cost of related party sales	12,180	547,766	226,363	585,261
Cost of equipment rental	2,947	3,608	8,841	13,111
<b>Total cost of revenues</b>	<b>450,783</b>	<b>641,438</b>	<b>1,169,274</b>	<b>1,407,104</b>
<b>Gross margin</b>	<b>200,604</b>	<b>1,034,039</b>	<b>412,994</b>	<b>1,219,797</b>
<b>Operating costs and expenses:</b>				
Research and development	641,457	481,994	1,760,803	992,110
Selling, general and administrative	1,667,503	1,389,175	4,580,000	3,589,573
<b>Total operating costs and expenses</b>	<b>2,308,960</b>	<b>1,871,169</b>	<b>6,340,803</b>	<b>4,581,683</b>
<b>Loss from operations</b>	<b>(2,108,356 )</b>	<b>(837,130 )</b>	<b>(5,927,809 )</b>	<b>(3,361,886 )</b>
<b>Other income (expense):</b>				
Interest income	13,861	21,708	47,890	47,331
Other expense	(2,371 )	(1,318 )	(6,950 )	(3,451 )
<b>Total other income</b>	<b>11,490</b>	<b>20,390</b>	<b>40,940</b>	<b>43,880</b>
<b>Loss before income taxes</b>	<b>(2,096,866 )</b>	<b>(816,740 )</b>	<b>(5,886,869 )</b>	<b>(3,318,006 )</b>
<b>Provision for income taxes</b>	<b>(988 )</b>	<b>(800 )</b>	<b>(988 )</b>	<b>(800 )</b>
<b>Net loss and comprehensive loss</b>	<b>\$ (2,097,854 )</b>	<b>\$ (817,540 )</b>	<b>\$ (5,887,857 )</b>	<b>\$ (3,318,806 )</b>
<b>Net loss per common share:</b>				
Basic	\$ (0.07 )	\$ (0.03 )	\$ (0.20 )	\$ (0.12 )
Diluted	\$ (0.07 )	\$ (0.03 )	\$ (0.20 )	\$ (0.12 )

Weighted average number of  
shares outstanding:

Basic	29,717,000	29,612,000	29,696,000	28,553,000
Diluted	29,717,000	29,612,000	29,696,000	28,553,000

See accompanying notes to condensed financial statements

BSD MEDICAL CORPORATION  
Condensed Statements of Cash Flows  
(Unaudited)

	Nine Months Ended May 31,	
	2012	2011
<b>Cash flows from operating activities:</b>		
Net loss	\$(5,887,857 )	\$(3,318,806 )
<b>Adjustments to reconcile net loss to net cash used in operating activities:</b>		
Depreciation and amortization	113,207	111,216
Stock-based compensation	891,054	728,697
Stock issued for services	180,000	150,164
Loss on disposition of property and equipment	118	-
Decrease (increase) in:		
Receivables	542,204	(700,504 )
Income tax receivable	-	50,000
Inventories	87,954	131,238
Other current assets	(30,215 )	(5,859 )
Increase (decrease) in:		
Accounts payable	(64,597 )	99,372
Accrued liabilities	(132,176 )	71,224
Customer deposits	-	25,000
Deferred revenue	(2,317 )	(26,185 )
<b>Net cash used in operating activities</b>	<b>(4,302,625 )</b>	<b>(2,684,443 )</b>
<b>Cash flows from investing activities:</b>		
Purchase of property and equipment	(96,345 )	(174,035 )
<b>Cash flows from financing activities:</b>		
Net proceeds from the sale of common stock	-	9,702,656
Proceeds from the exercise of warrants	-	2,989,407
Proceeds from the exercise of stock options	-	256,120
<b>Net cash provided by financing activities</b>	<b>-</b>	<b>12,948,183</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(4,398,970 )</b>	<b>10,089,705</b>
Cash and cash equivalents, beginning of the period	17,135,968	8,483,565
<b>Cash and cash equivalents, end of the period</b>	<b>\$12,736,998</b>	<b>\$18,573,270</b>

See accompanying notes to condensed financial statements



BSD MEDICAL CORPORATION  
Notes to Condensed Financial Statements  
(Unaudited)

Note 1. Basis of Presentation

The interim financial information of BSD Medical Corporation (the “Company”) as of May 31, 2012 and for the three months and nine months ended May 31, 2012 and 2011 is unaudited, and the condensed balance sheet as of August 31, 2011 is derived from our audited financial statements. The accompanying unaudited condensed balance sheets as of May 31, 2012 and August 31, 2011, the related unaudited condensed statements of operations and comprehensive loss for the three months and nine months ended May 31, 2012 and 2011, and the related unaudited condensed statements of cash flows for the nine months ended May 31, 2012 and 2011 have been prepared in accordance with U.S. generally accepted accounting principles for interim financial reporting and pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). The condensed financial statements do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. These condensed financial statements should be read in conjunction with the notes thereto, and the financial statements and notes thereto included in our annual report on Form 10-K for the year ended August 31, 2011.

All adjustments (consisting only of normal recurring adjustments) necessary for the fair presentation of our financial position as of May 31, 2012 and August 31, 2011 and our results of operations for the three months and nine months ended May 31, 2012 and 2011, and our cash flows for the nine months ended May 31, 2012 and 2011 have been included. The results of operations for the three months and nine months ended May 31, 2012 may not be indicative of the results for our fiscal year ending August 31, 2012.

Certain amounts in the prior periods have been reclassified to conform to the current period presentation.

Note 2. Inventories

Inventories consisted of the following:

	May 31, 2012	August 31, 2011
Parts and supplies	\$ 1,181,381	\$ 1,248,534
Work-in-process	957,640	1,110,362
Finished goods	279,239	147,318
Reserve for obsolete inventory	(100,000 )	(100,000 )
Inventories, net	\$ 2,318,260	\$ 2,406,214

## Note 3. Property and Equipment

Property and equipment consisted of the following:

	May 31, 2012	August 31, 2011
Equipment	\$ 1,372,363	\$ 1,314,814
Rental equipment	58,940	58,940
Furniture and fixtures	298,576	298,576
Leasehold improvements	54,736	47,005
Building	956,000	956,000
Land	244,000	244,000
	2,984,615	2,919,335
Less accumulated depreciation	(1,539,903)	(1,473,438)
Property and equipment, net	\$ 1,444,712	\$ 1,445,897

## Note 4. Stockholders' Equity

The Company has 10,000,000 authorized shares of \$.001 par value preferred stock. As of May 31, 2012 and August 31, 2011, there were no shares of preferred stock outstanding. The Company also has 80,000,000 authorized shares of \$.001 par value common stock.

## Stock Offerings

On October 1, 2009, our universal shelf registration statement was declared effective by the SEC for the issuance of common stock, preferred stock, warrants, senior debt, subordinated debt and units up to an aggregate amount of \$50.0 million. We may periodically offer one or more of these securities in amounts, prices and on terms to be announced when and if the securities are offered. At the time any of the securities covered by the registration statement are offered for sale, a prospectus supplement will be prepared and filed with the SEC containing specific information about the terms of any such offering.

We have previously completed four stock offerings utilizing our universal shelf registration statement. Each of these offerings was completed during calendar year 2010, and we received total net proceeds of approximately \$16.2 million.

## Warrants

During the nine months ended May 31, 2011, investors exercised warrants issued in the stock offerings to purchase a total of 1,501,134 common shares, with net proceeds to the Company of approximately \$3.0 million.

A summary of the outstanding warrants issued in the stock offerings as of May 31, 2012, and changes during the nine months then ended, is as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contract Term (Years)
Outstanding at August 31, 2011	2,408,523	\$ 4.56	
Issued	-	-	
Exercised	-	-	
Forfeited or expired	-	-	
Outstanding and exercisable at May 31, 2012	2,408,523	\$ 4.56	3.73

Note 5. Net Loss Per Common Share

The computation of basic earnings per common share is based on the weighted average number of shares outstanding during the period. The computation of diluted earnings per common share is based on the weighted average number of shares outstanding during the period plus the weighted average common stock equivalents which would arise from the exercise of stock options and warrants outstanding using the treasury stock method and the average market price per share during the period.

The shares used in the computation of our basic and diluted earnings per share are reconciled as follows (rounded to thousands):

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2012	2011	2012	2011
Weighted average number of shares outstanding – basic	29,717,000	29,612,000	29,696,000	28,553,000
Dilutive effect of stock options and warrants	-	-	-	-
Weighted average number of shares outstanding – diluted	29,717,000	29,612,000	29,696,000	28,553,000

No common shares issuable upon exercise of stock options or warrants are included in the computation of diluted weighted average number of shares for the three months and nine months ended May 31, 2012 and 2011 because the effect would be anti-dilutive. As of May 31, 2012, we had outstanding options and warrants to purchase a total of 5,581,762 shares of our common stock that could have a future dilutive effect on the calculation of earnings per share.



## Note 6. Related Party Transactions

During the three months ended May 31, 2012 and 2011, we had sales of \$13,757 and \$1,017,845, respectively, to entities controlled by a significant stockholder and member of the Board of Directors. These related party transactions represent approximately 2% and 61% of total sales for each respective three-month period.

During the nine months ended May 31, 2012 and 2011, we had sales of \$315,163 and \$1,058,597, respectively, to these related parties, representing approximately 20% and 40% of total sales for each respective nine-month period.

As of May 31, 2012 and August 31, 2011, receivables included \$14,757 and \$408,323, respectively, from these related parties.

## Note 7. Stock-Based Compensation

We have both an employee and director stock incentive plan, which are described more fully in Note 10 in our 2011 Annual Report on Form 10-K. As of May 31, 2012, we had approximately 2,689,000 shares of common stock reserved for future issuance under the stock incentive plans.

Stock-based compensation cost is measured at the grant date based on the value of the award granted using the Black-Scholes option pricing model, and recognized over the period in which the award vests. For stock awards no longer expected to vest, any previously recognized stock compensation expense is reversed in the period of termination. The stock-based compensation expense has been allocated to the various categories of operating costs and expenses in a manner similar to the allocation of payroll expense as follows:

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2012	2011	2012	2011
Cost of sales	\$ 16,021	\$ 16,442	\$ 48,067	\$ 21,062
Research and development	44,956	64,571	154,725	120,834
Selling, general and administrative	249,567	251,358	688,262	586,801
<b>Total</b>	<b>\$ 310,544</b>	<b>\$ 332,371</b>	<b>\$ 891,054</b>	<b>\$ 728,697</b>

During the nine months ended May 31, 2012, we granted employees 373,000 stock options at exercise prices ranging from \$2.04 to \$2.58 per share and with one third vesting each year for the next three years. The estimated weighted average grant date fair value per share of these stock options was \$1.31, and our weighted average assumptions used in the Black-Scholes valuation model to determine this estimated fair value are as follows:

Expected volatility	69.93%
Expected dividends	0%
Expected term	7.30 years
Risk-free interest rate	1.34%

Unrecognized stock-based compensation expense expected to be recognized over the estimated weighted-average amortization period of 1.34 years is approximately \$2,144,000 as of May 31, 2012.

A summary of the time-based stock option awards as of May 31, 2012, and changes during the nine months then ended, is as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contract Term (Years)	Aggregate Intrinsic Value
Outstanding at August 31, 2011	2,852,239	\$ 3.74		
Granted	373,000	2.24		
Exercised	-	-		\$ -
Forfeited or expired	(52,000 )	4.08		
Outstanding at May 31, 2012	3,173,239	\$ 3.56	6.62	\$ 80,491
Exercisable at May 31, 2012	1,508,800	\$ 4.00	5.63	\$ 80,491

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value, based on our closing stock price of \$1.61 as of May 31, 2012, which would have been received by the holders of in-the-money options had the option holders exercised their options as of that date.

#### Note 8. Research and Development Expenses

In November 2010, we were awarded two separate U.S. government grants under the Qualifying Therapeutic Discovery Project (“QTDP”) Program. We submitted grant applications for our BSD-2000 Hyperthermia System and our MicroThermX® Microwave Ablation System, and both applications were approved for the maximum award for a single program of \$244,479, or a total of \$488,958. In order to qualify for the QTDP grants, the project must have the potential to develop new treatments that address “unmet medical needs” or chronic and acute diseases; reduce long-term health care costs; represent a significant advance in finding a cure for cancer; advance U.S. competitiveness in the fields of life, biological, and medical sciences; or create or sustain well-paying jobs, either directly or indirectly. The QTDP was created by Congress in March 2010 as part of the Patient Protection and Affordable Care Act and provides a tax credit or a grant equal to 50% of eligible costs and expenses for tax years 2009 and 2010.

We recorded the \$488,958 proceeds from the QTDP grants as an offset to research and development expenses in the three months ended November 30, 2010.

#### Note 9. Supplemental Cash Flow Information

We paid no amounts for interest expense during the nine months ended May 31, 2012 and 2011. We paid \$988 and \$800 for income taxes during the nine months ended May 31, 2012 and 2011, respectively.

During the nine months ended May 31, 2012, we had no non-cash financing and investing activities.

During the nine months ended May 31, 2011, we had the following non-cash financing and investing activities:

- Increased common stock and decreased additional paid-in capital by \$7.

#### Note 10. Recent Accounting Pronouncements

Accounting Standards Update (“ASU”) No. 2011-08, Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment, was issued in September 2011. The objective of this update is to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Previous guidance under Topic 350 required an entity to test goodwill for impairment, on at least an annual basis, by comparing the fair value of a reporting unit with its carrying amount, including goodwill (step one). If the fair value of a reporting unit is less than its carrying amount, then the second step of the test must be performed to measure the amount of the impairment loss, if any. Under the amendments in this update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. This update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, or our fiscal quarter ended May 31, 2012. Since we currently have no reported goodwill balances, the adoption of this pronouncement had no material impact on our financial statements.

#### Note 11. Subsequent Events

Subsequent to May 31, 2012, the Board of Directors of the Company approved the grant of a total of 25,000 stock options to an employee, with an exercise price of \$1.74 per share and with one third vesting each year for the next three years.



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

This Management's Discussion and Analysis of Financial Condition and Results of Operations and other parts of this report contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can also be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Forward-Looking Statements" below. The following discussion should be read in conjunction with our financial statements and notes thereto included in this report. We assume no obligation to revise or update any forward-looking statements for any reason, except as required by law.

### Overview

We develop, manufacture, market and service systems to treat cancer and benign diseases using heat therapy delivered using focused radiofrequency (RF) and microwave energy. Our business objectives are to commercialize our products for the treatment of cancer and to further expand our products to treat other diseases and medical conditions. Our product lines for cancer therapy have been created to offer hospitals and clinics a complete solution for thermal treatment of cancer using microwave/RF systems.

### MicroThermX® Microwave Ablation System

Our MicroThermX® Microwave Ablation System ("MicroThermX®") is a compact, mobile, state-of-the-art, proprietary system that includes a microwave generator, single-patient-use disposable antennas, and a thermistor-based temperature monitoring system. The innovative design of the MicroThermX® is the first of its kind that allows delivery of higher power levels using a single generator. The MicroThermX® utilizes innovative, patented, synchronous phased array microwave delivery technology that was developed by the Company. This proprietary microwave technology provides larger and more uniform size of ablations during a single procedure. The MicroThermX® introduces into our product line an innovative disposable antenna ("SynchroWave antenna"). Up to three SynchroWave antennas are used in each ablation treatment, which will provide a significant ongoing revenue stream after the sale of the system. The soft tissue ablation world market potential is estimated to exceed \$2.3 billion.

In August 2010, the FDA granted us a 510(k) clearance to market the MicroThermX® for ablation of soft tissue. Clearance from the FDA of the 510(k) Premarket Notification submission authorizes the commercial sale of the MicroThermX® in the United States. We have also received CE Marking for the MicroThermX®, which allows us to market the MicroThermX® in the thirty countries that comprise the European Union ("EU") and the European Free Trade Association ("EFTA"). CE Marking is also recognized in many countries outside of the EU, providing us the ability to market the MicroThermX® to a number of international markets. As further discussed below, we have established distribution in a number of EU countries and have accepted purchase orders for and have shipped both MicroThermX® systems and SynchroWave antennas.

Increased sales activity has resulted in a full schedule of clinical evaluations and an increase in the number of sites evaluating MicroThermX® equipment for purchase. We have placed a select number of MicroThermX® systems with pivotal, high-profile, interventional oncology opinion leaders. These medical facilities continue to reorder disposable SynchroWave antennas, validating the ongoing revenue stream we anticipate. Existing users of the MicroThermX® continue to report positive clinical results in the treatment of cancerous tumors.

We have successfully treated in excess of 150 patients with the MicroThermX® at hospitals throughout the U.S. and Europe. Clinicians have used the MicroThermX® to treat patients with cancers of the liver, lung, bone, and kidneys. These evaluations represent an important milestone in the MicroThermX® sales cycle. However, with hospital capital budgeting, committee review and other approvals, the sales cycle for the MicroThermX® may extend to well over six months. Political and economic uncertainty in the industry due to recent government healthcare reform is also slowing hospital acquisition of capital equipment at all levels. This makes it difficult to predict when significant revenues from the sale of the MicroThermX® and related disposables will begin.

To bolster our MicroThermX® sales line and potentially accelerate and maximize revenues, we have recently added a MicroThermX® fee-per-use equipment rental program. We have experienced ongoing success with a MicroThermX® fee-per-use equipment rental program in the Salt Lake City, Utah area. The Company launched a program with 5 hospitals in Salt Lake City that allowed hospitals to purchase disposable SynchroWave antennas and pay a fee-per-use equipment rental for the treatment of patients using the MicroThermX®, dramatically shortening the sales cycle. This rental program has generated a revenue stream from sales of disposable SynchroWave antennas combined with highly profitable equipment rental fees, and we continue an aggressive rollout of this successful equipment rental program throughout the U.S.

As part of the expansion program, we have hired new direct sales representatives in key major metropolitan areas who will provide “personal service” to new users of microwave ablation technique. These new hires are experienced interventional sales representatives with seasoned contacts in the field of interventional oncology. We also recently announced the addition of a new Vice President of Sales and Marketing with a 36 year history in marketing medical equipment to physicians. He will initially focus his efforts exclusively on the worldwide sale of our MicroThermX® line of products and the implementation of our fee-per-use equipment rental program.

We also continue our emphasis on Europe and other international markets. We recently hired a Director of International Sales, have met with several international distribution firms and have entered into exclusive distribution agreements with specialty distribution firms in Ireland, Northern Ireland, and The Netherlands. We also continue to have success with sales in Italy. These firms have purchased MicroThermX® systems and SynchroWave antennas. We have provided our European sales teams with extensive hands-on training to ensure success in clinical use of the MicroThermX® system. We continue to build our European sales and distribution network to expand upon a dedicated team of medically trained sales representatives presenting the advantages of the MicroThermX® to interventional oncologists throughout key markets in Europe. We anticipate reaching agreements with additional international distribution firms, and we anticipate additional international shipments of the MicroThermX® and supplies of SynchroWave antennas in calendar year 2012.

#### Hyperthermia Systems

Our hyperthermia cancer treatment systems, which have been in use for several years in the United States, Europe and Asia, are used to treat certain tumors with heat (hyperthermia) while increasing the effectiveness of other therapies such as radiation therapy. We have developed extensive intellectual property, multiple products in the market and established distribution in the United States, Europe and Asia. Certain of our hyperthermia systems have received regulatory approvals and clearances in the United States, Europe and China.

BSD-500. Our BSD-500 Hyperthermia System, or the BSD-500, is used to deliver either superficial hyperthermia therapy, which is non-invasive and delivered externally using antennae placed over the tumor, or interstitial hyperthermia therapy, which is delivered using antennae that are inserted into the tumor, or both. These systems include a touch screen display monitor by which the operator controls the hyperthermia treatment, computer equipment and software that controls the delivery of microwave energy to the tumor, and a generator that creates the needed microwave energy for the treatment. Additionally, these systems include a variety of applicator (radiating

antennae) configurations, depending on the system. Various configurations of non-invasive applicators (antennae) are used for superficial hyperthermia treatments. For interstitial hyperthermia treatments, the system may include up to 24 small microwave heat-delivering antennae that are inserted into catheters used for internal radiation therapy (called brachytherapy).

Our primary FDA approval (described as a pre-market approval, or PMA, which is the standard FDA approval required to market Class III medical devices in the United States) for the BSD-500 is for the use of hyperthermia and radiation therapy to treat certain tumors using the BSD-500. There are some clinical studies that have been published that show the effectiveness and safety for the use of hyperthermia and certain chemotherapy drugs for the treatment of some cancers. However, we do not currently have FDA approval for the use of hyperthermia in conjunction with chemotherapy. Physicians are allowed to utilize medical devices that have been approved or cleared by the FDA, including the BSD-500, for off label indications (indications for use that are not included in the FDA approval or clearance), but a manufacturer cannot promote for an off label use in the United States, as the FDA considers this to be an unproven clinical application.

We have received FDA approval through FDA supplements for implementation of a new operating system and a new power generation system and other commercial upgrades for the BSD-500 configurations. We have also certified the BSD-500 system for the CE Mark, which is required for export into some European and non-European countries.

BSD-2000. The BSD-2000 Hyperthermia System, or the BSD-2000, family of products includes the BSD-2000, the BSD-2000/3D and the BSD-2000/3D/MR. These systems non-invasively deliver localized therapeutic heating (hyperthermia) to solid tumors by applying radiofrequency (RF) energy to certain cancerous tumors, including those located deep within the body. These systems consist of four major subsystems: an RF power generator delivery subsystem; a proprietary, thermistor-based, thermometry subsystem; a computerized monitoring and control subsystem; and an applicator subsystem that includes an applicator and patient support system; as well as various accessories. The BSD-2000 delivers energy to a patient using a power source and an array of multiple antennae that surround the patient's body. The BSD-2000 systems create a central focusing of energy that can be adjusted to target the shape, size, and location of the tumor, thus providing dynamic control of the heating delivered to the tumor region. The basic BSD-2000 has eight microwave antennae, enabling electronic steering of energy within the patient's body. The BSD-2000/3D has 24 microwave antennae enabling additional electronic steering along the long axis of the body. The 3D steering is particularly useful when used with a magnetic resonance system that provides non-invasive 3D imaging of the heated regions, thus permitting the clinician to view the heating pattern in the tumor and steer the energy to the tumor site.

We have received CE Marking for the BSD-2000 family of products, which allows us to market the BSD-2000 systems in the thirty countries that comprise the EU and the EFTA. CE Marking is also recognized in many countries outside of the EU, providing us the ability to market the BSD-2000 family of products to a number of international markets. We have also obtained regulatory approval for the sale of the BSD-2000 in the People's Republic of China.

On May 18, 2009, the FDA granted HUD designation for our BSD-2000 for use in conjunction with radiation therapy for the treatment of cervical carcinoma patients who are ineligible for chemotherapy. This is the first of the two steps required to obtain HDE marketing approval. Subsequent to the FDA granting the HUD for the BSD-2000, which confirms that the intended use population is fewer than 4,000 patients per year, we filed an HDE submission with the FDA.

On November 21, 2011, we announced that the Company had obtained HDE marketing approval for the BSD-2000 from the FDA. The BSD-2000 is approved for use in conjunction with radiation therapy for the treatment of cervical cancer patients who normally would be treated with combined chemotherapy and radiation but are ineligible for chemotherapy due to patient related factors. The HDE approval authorizes the commercial sale of the BSD-2000. An HDE approval is obtained after a company has demonstrated the product's safety and probable benefit for the treatment of a disease affecting fewer than 4,000 people in the United States every year. In addition, we cannot charge an amount for an HDE approved device that exceeds the costs of research and development, fabrication, and distribution. A device can have both PMA and an HDE approval as long as the approvals are for different indications for use. In addition, a product can have multiple HDE approvals for different applications, and we may decide to

pursue a PMA and/or additional HDE approvals for the BSD-2000 in the future.

Development of the BSD-2000, the BSD-2000/3D and the BSD-2000/3D/MR has required substantial effort involving the cooperative work of such United States research institutions as Duke University, Northwestern University, University of Southern California, Stanford University, University of Utah and University of Washington St. Louis. Contributing European research institutions include Daniel den Hoed Cancer Center of the Academisch Ziekenhuis (Rotterdam, Netherlands), Haukeland University Hospital (Bergen, Norway), Dusseldorf University Medical School, Tübingen University Medical School, Essen University Hospital, Charité Medical School of Humboldt University (Berlin), Luebeck University Medical School, Munich University Medical School Grosshadern, Interne Klinik Argirov of the Munich Comprehensive Cancer Center, University of Erlangen (all of Germany), University of Verona Medical Center (Italy), Graz University Medical School (Austria) and Kantonsspital Aarau (Switzerland).

BSD-2000/3D. Through research funded by the National Cancer Institute in the United States and supportive efforts by other domestic and international research institutions, we enhanced the BSD-2000 to create the BSD-2000/3D. The BSD-2000/3D adds three-dimensional steering of deep focused energy, enabling additional electronic steering along the long axis of the body. As part of our international collaborative research efforts, sophisticated treatment planning software for the BSD-2000/3D has also been developed.

We have obtained the CE Marking necessary to export the BSD-2000/3D to certain European countries and other countries requiring CE Mark certification.

BSD-2000/3D/MR. As a further enhancement of the BSD-2000/3D, we have added to it the option of concurrent magnetic resonance imaging, or MRI, used for monitoring the delivery of deep hyperthermia therapy. Using sophisticated microwave filtering and imaging software, the BSD-2000/3D/MR allows an MRI system to be interfaced with and operate simultaneously with a BSD-2000/3D. The development of MRI treatment monitoring is a significant breakthrough in the development of hyperthermic oncology primarily because it allows non-invasive “on-line” review of hyperthermic treatment progress.

We installed and tested the first BSD-2000/3D/MR system at a leading German oncological research institution, the Clinic of Medical Oncology of the Klinikum Großhadern Medical School of Ludwigs-Maximilians-Universität München, in Munich, Germany. We have since installed BSD-2000/3D/MR systems at multiple other locations.

We have obtained the CE Marking necessary to export the BSD-2000/3D to certain European countries and other countries requiring CE Mark certification, provided we interface the system with an MRI system that also is approved in Europe.

Marketing and Distribution of Hyperthermia Systems. To support our direct sales and marketing efforts for our hyperthermia systems and products in the United States, we currently utilize independent sales representatives supported by senior management of the Company.

Historically, a significant portion of our revenues have been derived from sales to Dr. Sennewald Medizintechnik GmbH (“Medizintechnik”) located in Munich, Germany, which is our exclusive distributor of hyperthermia systems in Germany, Austria, Switzerland, Israel, Russia, and in certain medical institutions in Belgium and the Netherlands. This company is owned by Dr. Gerhard W. Sennewald, one of our directors and a significant stockholder. We have also sold systems in Poland and Italy, and have conducted our own direct sales and marketing efforts in other countries in Europe, India, and Asia.

In 2005, we entered into an agreement with Dalian Orientech Co. LTD (“Orientech”), a privately owned company, to assist us in obtaining regulatory approval for the sale of the BSD-2000 in the People’s Republic of China, and thereafter to act as our distributor for the sale of the BSD-2000 in that country. We subsequently obtained Chinese regulatory approval, allowing the distributor to begin to market and sell the BSD-2000 system to hospitals in China. In February 2012, we finalized a new exclusive distribution agreement with Orientech, including a requirement to purchase a minimum number of hyperthermia systems from us each year, and Orientech is leading efforts to renew our Chinese regulatory approval.

In December 2011, we announced that the Company has signed an exclusive agreement with CyberKnife Korea (“CKK”) for the sale and distribution of our hyperthermia products in South Korea. CKK is a premier distributor of sophisticated medical devices in South Korea and represents a number of major medical device companies. CKK is a leading distributor of oncology products in South Korea and has established strong relationships with radiation oncologists throughout the country. As part of the agreement, CKK is required to purchase a minimum number of hyperthermia systems from us each year. We will initially focus on the regulatory approval for and distribution of the BSD-500 in South Korea and then expand distribution to include the BSD-2000.

## Results of Operations

### Fluctuation in Operating Results

Our results of operations have fluctuated in the past and may fluctuate in the future from year to year as well as from quarter to quarter. Revenue may fluctuate as a result of factors relating to the demand and market acceptance for our ablation and hyperthermia systems and related component parts and services, world-wide economic conditions, availability of financing for our customers, changes in the medical capital equipment market, changes in order mix and product order configurations, competition, regulatory developments, insurance reimbursement and other matters. Operating expenses may fluctuate as a result of the timing of sales and marketing activities, research and development, and general and administrative expenses associated with our potential growth. For these and other reasons described elsewhere, our results of operations for a particular period may not be indicative of operating results for any other period.

### Revenues

We recognize revenue from the sale of our ablation and hyperthermia cancer treatment systems and related parts and accessories (collectively, product sales), the sale of consumable devices used with certain of our systems, equipment rental, training, service support contracts and other miscellaneous revenues. Our revenues can fluctuate significantly from period to period because our sales, to date, have been based upon a relatively small number of hyperthermia systems, the sales price of each being substantial enough to greatly impact revenue levels in the periods in which they occur. Sales of a few hyperthermia systems, particularly BSD-2000/3D/MR systems, can cause a large change in our revenues from period to period and the sales cycle for our systems generally extends over multiple financial reporting periods. In addition, differences in the configuration of the hyperthermia systems sold, pricing, and other factors can result in significant differences in the sales price per system and in the total revenues reported in a given period. As a result, there may be quarterly financial reporting periods where we may report no or minimal revenues from the sale

of hyperthermia systems. Through May 31, 2012, we had minimal but growing revenues from our MicroThermX® family of products. As previously discussed, to bolster our MicroThermX® sales line and potentially accelerate and maximize revenues, we are engaged in a MicroThermX® fee-per-use equipment rental program. We have experienced ongoing success with a MicroThermX® fee-per-use equipment rental program in the Salt Lake City, Utah area. This rental program has generated a revenue stream from sales of disposable SynchroWave antennas combined with highly profitable equipment rental fees, and we believe it can produce the same successful results throughout the U.S.



To date, hyperthermia therapy has not gained wide acceptance by cancer-treating physicians. We believe this is due in part to the lingering impression created by the inability of early hyperthermia therapy technologies to focus and control heat directed at specific tissue locations and inaccurate conclusions drawn in early scientific studies that hyperthermia was only marginally effective. Additionally, we do not believe that reimbursement rates from third-party payers have been adequate to promote hyperthermia therapy acceptance in the medical community.

We also believe the continuing worldwide economic downturn has made it difficult for many of our customers to obtain approval for the purchase of our hyperthermia and microwave ablation systems and to arrange related financing.

Political, economic and regulatory influences are subjecting the U.S. healthcare industry to fundamental changes. We may continue to face significant uncertainty in the industry due to recent governmental healthcare reform. We believe the uncertainties regarding the ultimate features of reform initiatives and their enactment and implementation may also have an adverse effect on our customers' purchasing decisions regarding our products and services.

As a result of these negative factors, we have been unable to sustain a significant increase in the number of hyperthermia systems sold, and we believe these difficulties may continue to negatively impact the sales of our hyperthermia systems, the market introduction of our MicroThermX®, and our operating results.

The following table summarizes the number of systems sold for the three months and nine months ended May 31, 2012 and 2011:

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2012	2011	2012	2011
MicroThermX®	1	-	4	1
Hyperthermia Systems:				
BSD-500	1	1	2	3
BSD-2000	1	1	2	2
BSD-2000/3D	-	-	-	-
BSD-2000/3D/MR	-	1	-	1
Total Hyperthermia Systems	2	3	4	6

Our sales to related parties are comprised of the sale of hyperthermia systems and related component parts and services sold to Medizintechnik. Dr. Sennewald, one of our directors and significant stockholders, is a stockholder, executive officer and a director of Medizintechnik. At times, these related party sales represent a significant portion of our revenues. We derived \$13,757, or approximately 2%, of our total revenues in the three months ended May 31, 2012 from sales to related parties, compared to \$1,017,845, or approximately 61%, in the three months ended May 31, 2011. We derived \$315,163, or approximately 20%, of our total revenues in the nine months ended May 31, 2012 from sales to related parties, compared to \$1,058,597, or approximately 40%, in the nine months ended May 31, 2011. We had no sales of hyperthermia systems to related parties in the three months ended May 31, 2012.

The following tables summarize the sources of our revenues for the three months and nine months ended May 31, 2012 and 2011:

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2012	2011	2012	2011
<b>Non-Related Parties</b>				
Product sales	\$ 485,753	\$ 550,000	\$ 838,753	\$ 1,316,350
Consumable devices	66,955	50,544	168,625	51,144
Service contracts	52,370	37,292	139,056	110,672
Other	6,652	9,896	19,221	28,738
<b>Total</b>	<b>\$ 611,730</b>	<b>\$ 647,732</b>	<b>\$ 1,165,655</b>	<b>\$ 1,506,904</b>
<b>Related Parties</b>				
Product sales	\$ -	\$ 1,010,687	\$ 294,850	\$ 1,011,587
Consumable devices	11,550	900	11,550	28,650
Other	2,207	6,258	8,763	18,360
<b>Total</b>	<b>\$ 13,757</b>	<b>\$ 1,017,845</b>	<b>\$ 315,163</b>	<b>\$ 1,058,597</b>

During the three months ended May 31, 2012 and 2011, we had equipment rental revenues of \$25,900 and \$9,900, respectively. During the nine months ended May 31, 2012 and 2011, we had equipment rental revenues of \$101,450 and \$61,400, respectively. The increase in equipment rental revenues during the first nine months of the current fiscal year is primarily the result of fee-per-use rental revenues from our MicroThermX® product line.

Total revenues for the three months ended May 31, 2012 were \$651,387 compared to \$1,675,477 for the three months ended May 31, 2011, a decrease of \$1,024,090, or approximately 61%. The overall decrease in revenues in the third quarter of the current fiscal year is due primarily to fewer hyperthermia systems sold including a BSD-2000/3D/MR sold in the prior year third quarter to related parties, partially offset by the increase in equipment rental revenues and sales of consumable devices from our MicroThermX® product line to non-related parties.

Total revenues for the nine months ended May 31, 2012 were \$1,582,268 compared to \$2,626,901 for the nine months ended May 31, 2011, a decrease of \$1,044,633, or approximately 40%. We sold two less hyperthermia systems during the first nine months of the current fiscal year, including a BSD-2000/3D/MR sold in the first nine months of the prior fiscal year to related parties. However, the decrease in hyperthermia systems revenues was partially offset by the increase in MicroThermX® systems sold and equipment rental revenues and sales of consumable devices from our MicroThermX® product line.



## Cost of Revenues

Cost of sales includes raw material, labor and allocated overhead costs. We calculate and report separately cost of sales for both non-related and related party sales, which are sales to Medizintechnik and Dr. Sennewald. Cost of sales as a percentage of sales will fluctuate from period to period depending on the mix of sales for the period and the type and configuration of the hyperthermia systems sold during the period.

Cost of equipment rental includes installation, training, maintenance and support costs and depreciation of rental equipment.

Total cost of revenues for the three months ended May 31, 2012 was \$450,783 compared to \$641,438 for the three months ended May 31, 2011, a decrease of \$190,655, or approximately 30%. Total cost of revenues for the nine months ended May 31, 2012 was \$1,169,274 compared to \$1,407,104 for the nine months ended May 31, 2011, a decrease of \$237,830, or approximately 17%. This decrease in cost of revenues in the current fiscal year resulted primarily from decreased revenues as described above, particularly fewer hyperthermia systems sold.

## Gross Margin

Our gross margin and gross margin percentage will fluctuate from period to period depending on the mix of revenues reported for the period and the type and configuration of the hyperthermia systems sold during the period. Our total gross margin was \$200,604 for the three months ended May 31, 2012, or approximately 31%, and \$1,034,039, or approximately 62%, for the three months ended May 31, 2011. Our total gross margin was \$412,994 for the nine months ended May 31, 2012, or approximately 26%, and \$1,219,797, or approximately 46%, for the nine months ended May 31, 2011. The decrease in gross margin and gross margin percentage in the first nine months of the current fiscal year resulted primarily from the sale of fewer hyperthermia systems in the current year, partially offset by the gross margin contributed by the increase in MicroThermX® systems sold and equipment rental revenues and sales of consumable devices from our MicroThermX® product line.

## Operating Costs and Expenses

Research and Development Expenses – Research and development expenses include expenditures for new product development and development of enhancements to existing products. Research and development expenses for the three months ended March 31, 2012 were \$641,457 compared to \$481,994 for the three months ended May 31, 2011, an increase of \$159,463, or approximately 33%. Research and development expenses were \$1,760,803 for the nine months ended May 31, 2012 compared to \$992,110 for the nine months ended May 31, 2011, an increase of \$768,693, or approximately 77%. Our research and development expenses for the nine months ended May 31, 2011 have been offset by the \$488,958 proceeds from two separate U.S. government grants under the QTDP Program. Increases in research and development expenses during the first nine months of the current fiscal year is due primarily to continued development and enhancements to our MicroThermX® line of products and to our hyperthermia systems.

Selling, General and Administrative Expenses – Selling, general and administrative expenses were \$1,667,503 for the three months ended May 31, 2012 compared to \$1,389,175 for the three months ended May 31, 2011, an increase of \$278,328, or approximately 20%. Selling, general and administrative expenses were \$4,580,000 for the nine months ended May 31, 2012 compared to \$3,589,573 for the nine months ended May 31, 2011, an increase of \$990,427, or approximately 28%. We implemented headcount reductions and other operating expense reduction measures in fiscal year 2011. However, as we continue the roll out of the MicroThermX® product line and the support of its global distribution network, we have increased our marketing and sales staff and incurred additional marketing, sales and related operating expenses. We believe that the level of our selling, general and administrative expenses may continue to increase over the levels reported for the first nine months of the current fiscal year, and the increase may be

significant.

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#### Other Income (Expense)

During the three months and nine months ended May 31, 2012 and 2011, other income (expense) was not material to our operations.

#### Liquidity and Capital Resources

Since inception through May 31, 2012, we have generated an accumulated deficit of \$35,304,444 where generally our operating revenues have been insufficient to cover our operating expenses. We have financed our operations primarily through the sale of our common stock, the exercise of stock options and warrants, and from the sale of an investment in a spinoff operation. As of May 31, 2012, we had cash and cash equivalents of \$12,736,998, comprised primarily of money market funds and savings accounts.

As of May 31, 2012, we had current liabilities totaling \$536,701, comprised of accounts payable, accrued liabilities and deferred revenue incurred in the normal course of our business. Our long-term liabilities consisted of deferred revenue of \$132,521.

#### Stock Offerings

On October 1, 2009, our universal shelf registration statement was declared effective by the SEC for the issuance of common stock, preferred stock, warrants, senior debt, subordinated debt and units up to an aggregate amount of \$50.0 million. We may periodically offer one or more of these securities in amounts, prices and on terms to be announced when and if the securities are offered. At the time any of the securities covered by the registration statement are offered for sale, a prospectus supplement will be prepared and filed with the SEC containing specific information about the terms of any such offering.

We have previously completed four stock offerings utilizing our universal shelf registration statement. Each of these offerings was completed during calendar year 2010, and we received total net proceeds of approximately \$16.2 million.

#### Warrant Exercises

During the nine months ended May 31, 2011, investors exercised warrants issued in the stock offerings to purchase a total of 1,501,134 common shares, with net proceeds to the Company of approximately \$3.0 million.

#### Cash Flows from Operating, Investing and Financing Activities

During the nine months ended May 31, 2012, we used net cash of \$4,302,625 in operating activities, primarily as a result of our net loss of \$5,887,857 decreased by non-cash expenses of \$1,184,379, including depreciation and amortization, stock-based compensation, stock issued for services and loss on disposition of property and equipment. Net cash used in operating activities also included an increase in other current assets of \$30,215 and decreases in accounts payable of \$64,597, accrued liabilities of \$132,176, and deferred revenue of \$2,317, partially offset by decreases in receivables of \$542,204 and inventories of \$87,954.

During the nine months ended May 31, 2011, we used net cash of \$2,684,443 in operating activities, primarily as a result of our net loss of \$3,318,806, decreased by non-cash expenses totaling \$990,077, including depreciation and amortization, stock-based compensation and stock issued for services. Net cash used in operating activities also included increases in receivables of \$700,504 and other current assets of \$5,859 and decreases in deferred revenue of \$26,185, partially offset by decreases in income tax receivable of \$50,000 and inventories of \$131,238, and increases in accounts payable of \$99,372, accrued liabilities of \$71,224 and customer deposits of \$25,000.

Net cash used in investing activities for the nine months ended May 31, 2012 and 2011 was \$96,345 and \$174,035, respectively, resulting from the purchase of property and equipment.

We had no net cash provided by or used in financing activities during the nine months ended May 31, 2012. Net cash provided by financing activities for the nine months ended May 31, 2011 was \$12,948,183, comprised of net proceeds from the sale of common stock of \$9,702,656, proceeds from the exercise of warrants of \$2,989,407 and proceeds from the exercise of stock options of \$256,120.

We believe that our current cash and cash equivalents will be sufficient to fund our operations for the next twelve months.

As of May 31, 2012, we had no significant commitments for the purchase of property and equipment.

We had no material off balance sheet arrangements as of May 31, 2012.

#### Critical Accounting Policies

The following is a discussion of our critical accounting policies and estimates that management believes are material to an understanding of our results of operations and which involve the exercise of judgment or estimates by management.

**Revenue Recognition:** Revenue from the sale of cancer treatment systems is recognized when a purchase order has been received, the system has been shipped, the selling price is fixed or determinable, and collection is reasonably assured. Most system sales are F.O.B. shipping point; therefore, shipment is deemed to have occurred when the product is delivered to the transportation carrier. Most system sales do not include installation. If installation is included as part of the contract, revenue is not recognized until installation has occurred, or until any remaining installation obligation is deemed to be perfunctory. Some sales of systems may include training as part of the sale. In such cases, the portion of the revenue related to the training, calculated based on the amount charged for training on a stand-alone basis, is deferred and recognized when the training has been provided. The sales of our cancer treatment systems do not require specific customer acceptance provisions and do not include the right of return except in cases where the product does not function as warranted by us. To date, returns have not been significant.

Revenue from the sale of consumable devices is recognized when a purchase order has been received, the devices have been shipped, the selling price is fixed or determinable, and collection is reasonably assured. Currently, our customers are not required to purchase a minimum number of disposable devices in connection with the purchase of our systems.

Revenue from training services is recorded when an agreement with the customer exists for such training, the training services have been provided, and collection is reasonably assured.





Revenue from service support contracts is recognized on a straight-line basis over the term of the contract, which approximates recognizing it as it is earned.

Revenue from equipment rental under an operating lease and from pay-per-use equipment rental is recognized when billed in accordance with the underlying agreements.

Our revenue recognition policy is the same for sales to both related parties and non-related parties. We provide the same products and services under the same terms for non-related parties as with related parties.

Sales to distributors are recognized in the same manner as sales to end-user customers.

Deferred revenue and customer deposits payable include amounts from service contracts as well as cash received for the sales of products, which have not been shipped.

**Inventory Reserves:** We maintain a reserve for obsolete inventories to reduce excess and obsolete inventories to their estimated net realizable value. This reserve is a significant estimate and we periodically review our inventory levels and usage, paying particular attention to slower-moving items. If projected sales do not materialize or if our hyperthermia systems do not receive increased market acceptance, we may be required to increase the reserve for obsolete inventories in future periods.

**Product Warranty:** We provide product warranties on our systems. These warranties vary from contract to contract, but generally consist of parts and labor warranties for one year from the date of installation. To date, expenses resulting from such warranties have not been material. We record a warranty expense at the time of each sale. This reserve is estimated based on prior history of service expense associated with similar units sold in the past.

**Allowance for Doubtful Accounts:** We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. This allowance is a significant estimate and is regularly evaluated by us for adequacy by taking into consideration factors such as past experience, credit quality of the customer base, age of the receivable balances, both individually and in the aggregate, and current economic conditions that may affect a customer's ability to pay. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

**Stock-based Compensation:** Stock-based compensation cost of stock options and other stock-based awards to employees and directors is measured at the grant date based on the estimated value of the award granted, using the Black-Scholes option pricing model, and recognized over the period in which the award vests. For stock awards no longer expected to vest, any previously recognized stock compensation expense is reversed in the period of termination. The stock-based compensation expense has been allocated to the various categories of operating costs and expenses in a manner similar to the allocation of payroll expense. The Black-Scholes valuation model utilizes inputs that are subject to change over time, including the volatility of the market price of our common stock, risk free interest rates, requisite service periods and assumptions made by us regarding the assumed life and vesting of stock options and stock-based awards. As new options or stock-based awards are granted, additional non-cash compensation expense will be recorded by us.

**Income Taxes:** We account for income taxes using the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.



We maintain valuation allowances where it is more likely than not that all or a portion of a deferred tax asset will not be realized. Changes in valuation allowances are included in our income tax provision in the period of change. In determining whether a valuation allowance is warranted, we evaluate factors such as prior earnings history, expected future earnings and our ability to carry back reversing items within two years to offset income taxes previously paid.

To the extent that we have the ability to carry back current period taxable losses to offset income taxes previously paid, we record an income tax receivable and a current income tax benefit.

#### Recent Accounting Pronouncements

Accounting Standards Update (“ASU”) No. 2011-08, Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment, was issued in September 2011. The objective of this update is to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Previous guidance under Topic 350 required an entity to test goodwill for impairment, on at least an annual basis, by comparing the fair value of a reporting unit with its carrying amount, including goodwill (step one). If the fair value of a reporting unit is less than its carrying amount, then the second step of the test must be performed to measure the amount of the impairment loss, if any. Under the amendments in this update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. This update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, or our fiscal quarter ended May 31, 2012. Since we currently have no reported goodwill balances, the adoption of this pronouncement had no material impact on our financial statements.

#### FORWARD-LOOKING STATEMENTS

With the exception of historical facts, the statements contained in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and other parts of this quarterly report on Form 10-Q are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which reflect our current expectations and beliefs regarding our future results of operations, performance and achievements. These statements are subject to risks and uncertainties and are based upon assumptions and beliefs that may or may not materialize. These forward-looking statements include, but are not limited to, statements concerning:

- our belief about the market opportunities for our products;
- our anticipated financial performance and business plan;
- our expectations regarding the commercialization of, and the potential revenue from, the BSD-2000, BSD 500 and MicroThermX® systems;
- our expectations that we will continue to incur expenses related to seeking governmental and regulatory approvals for our products;

- our belief that the MicroThermX® will be a major part of our business plan moving forward and that the growth in our revenues and our ultimate profitability will be largely dependent on the success of our MicroThermX® marketing and sales efforts;
- our expectations that we will have the same successful results from our MicroThermX® fee-per-use equipment rental program throughout the U.S. as we have experienced in the Salt Lake City, Utah area;
- our expectations regarding the manufacturing, marketing, distribution, roll out and revenues for the MicroThermX® and the estimated timing thereof;
- our expectations that the SynchroWave antennas to be used in conjunction with the MicroThermX® will represent a significant ongoing revenue stream;
  - our expectations that we will reach agreements with additional international distribution firms;
- our expectations that additional international shipments of the MicroThermX® and supplies of SynchroWave antennas will occur later in calendar year 2012;
  - our intentions to continue to devote substantial sums to research and development;
- our belief that the level of our operating expenses, including selling, general and administrative expenses, will increase and that the increase may be significant;
- our belief that our operating results, revenue and operating expenses may fluctuate in the future from year to year as well as from quarter to quarter; and
- our belief that our current cash and cash equivalents will be sufficient to finance our operations for the next twelve months.

We wish to caution readers that the forward-looking statements and our operating results are subject to various risks and uncertainties that could cause our actual results and outcomes to differ materially from those discussed or anticipated, including the factors set forth in Item 1A – “Risk Factors” in our Annual Report on Form 10-K for the year ended August 31, 2011 and our other filings with the Securities and Exchange Commission. We also wish to advise readers not to place any undue reliance on the forward-looking statements contained in this report, which reflect our beliefs and expectations only as of the date of this report. We assume no obligation to update or revise these forward-looking statements to reflect new events or circumstances or any changes in our beliefs or expectations, other than as required by law.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

There are no material changes to our market risk as described in our annual report on Form 10-K for the year ended August 31, 2011.

### Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures.

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our management including our principal executive officer and principal financial officer, of the

effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934 (“Exchange Act”). Based on this evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in applicable rules and forms and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, in a manner that allows timely decisions regarding required disclosure.

Changes in internal controls over financial reporting.

There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

### Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the risk factors reported in our Annual Report on Form 10-K for the year ended August 31, 2011.

### Item 6. Exhibits

The following exhibits are filed as part of this report:

Exhibit No.	Description of Exhibit
31.1	Certification of the Principal Executive Officer Required Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Principal Accounting Officer Required Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer Required Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Accounting Officer Required Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance
101.SCH	XBRL Schema
101.CAL	XBRL Calculation
101.DEF	XBRL Definition
101.LAB	XBRL Label
101.PRE	XBRL Presentation

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BSD MEDICAL CORPORATION

Date: July 9, 2012

/s/ Harold R. Wolcott  
Harold R. Wolcott  
President (Principal Executive Officer)

Date: July 9, 2012

/s/ Dennis P. Gauger  
Dennis P. Gauger  
Chief Financial Officer (Principal Accounting Officer)