BSD MEDICAL CORP
Form 10QSB
July 17, 2006

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

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

For the Quarterly Period Ended May 31, 2006

Commission file number 0-10783

BSD MEDICAL CORPORATION

Delaware	75-1590407
(State of Incorporation)	(IRS Employer Identification Number)
2188 West 2200 South Salt Lake City, Utah	84119
(Address of principal executive offices)	(Zip Code)

Issuer's telephone number: (801) 972-5555

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:

As of July 10, 2006, there were 21,021,668 shares of the Registrant's common stock, $0.001 par value per share, outstanding.

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

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

BSD MEDICAL CORPORATION
Condensed Balance Sheet
(Unaudited)

Assets	May 31, 2006

Current assets:	
Cash and cash equivalents	$ 542,446
Available-for-sale securities	27,273,927
Receivables, net of allowance for doubtful accounts of $42,500	603,309
Related party receivables	341,873
Inventories, net	1,518,210
Deferred tax asset	215,000
Other current assets	133,769
Total current assets	30,628,534
Property and equipment, net	306,923
Patents, net	21,720
	$ 30,957,177

Liabilities and Stockholders' Equity

Current liabilities:	
Accounts payable	$ 523,951
Accrued expenses	469,431
Income taxes payable	4,266,602
Deferred revenue	17,546
Total current liabilities	5,277,530
Total liabilities	5,277,530
Stockholders' equity:	
Preferred stock, $.001 par value; 10,000,000 authorized, no shares issued and outstanding	-
Common stock, $.001 par value; authorized 40,000,000 shares; issued 21,021,668 shares and outstanding 20,997,357 shares	21,022
Additional paid-in capital	25,504,433
Deferred compensation	(321,299)
Common stock in treasury 24,311 shares, at cost	(234)
Other comprehensive loss	(78,366)
Retained earnings	554,091
Net stockholders' equity	25,679,647
	$ 30,957,177

See accompanying notes to condensed financial statements

BSD MEDICAL CORPORATION

Condensed Statements of Operations
(Unaudited)
Periods ended May 31, 2006 and May 31, 2005

	Three Months Ended May 31,		Ni... End...
	2006	2005	2006
Sales	$ 264,050	$ 321,843	$ 1,004,272
Related party sales	448,721	43,370	669,041
Total sales	712,771	365,213	1,673,313
Costs and expenses:			
Cost of sales	167,464	267,600	680,918
Cost of related party sales	245,250	35,860	393,026
Research and development	380,623	270,803	945,527
Selling, general, and administrative	1,329,282	504,923	3,553,103
Total costs and expenses	2,122,619	1,079,186	5,572,574
Operating loss	(1,409,848)	(713,973)	(3,899,261)
Other income (expense):			
Interest income	411,777	43,306	960,990
Other income	5,935,315	5,460,462	17,750,601
Total other income	6,347,092	5,503,768	18,711,591
Income before income taxes	4,937,244	4,789,795	14,812,330
Provision for income taxes	1,949,621	1,841,000	5,506,785
Net income	$ 2,987,623	$ 2,948,795	$ 9,305,545

Net income per common and common

equivalent share,			
Basic	$ .14	$ .15	$ .45
Diluted	$ .13	$ .14	$ .42
Weighted average number of shares outstanding,			
Basic	20,926,000	20,144,000	20,683,000
Diluted	22,163,000	20,612,000	22,148,000

See accompanying notes to condensed financial statements

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BSD MEDICAL CORPORATION

Condensed Statements of Cash Flows
(Unaudited)
Periods ended May 31, 2006 and May 31, 2005

	Nin
	May 31, 2006
Cash flows from operating activities:	
Net Income	$ 9,305,545
Adjustments to reconcile net income to net cash used in operating activities:	
Depreciation and amortization	64,195
Gain on sale of investment in TherMatrx	(17,413,342)
Gain on sale of property	-
Non-cash stock compensation expense	48,471
Amortization of deferred compensation expense	75,950
(Increase) decrease in:	
Receivables	(335,760)
Related party receivables	(105,745)
Inventories	(383,857)
Deferred tax asset	(111,000)
Other current assets	(1,028)
Increase (decrease) in:	
Accounts payable	411,138
Accrued expenses	221,055
Income taxes payable	4,998,125

Deferred revenue	10,219
Deferred tax liability	(13,000)
Net cash used in operating activities	(3,229,031)
Cash flows from investing activities:	
Proceeds from sale of investment in TherMatrx	17,413,342
Purchase of available-for-sale securities	(14,770,709)
Purchase of property and equipment	(194,866)
Proceeds from sale of property and equipment	-
Net cash provided by investing activities	2,447,767
Cash flows from financing activities:	
Proceeds from issuance of common stock options	415,036
Net cash provided by financing activities	415,036
Change in cash and cash equivalents	(366,228)
Cash and cash equivalents, beginning of period	908,674
Cash and cash equivalents, end of period	$ 542,446

Supplemental Disclosure of Cash Flow Information

- The Company paid no cash for interest during the nine months ended May 31, 2006 and 2005 and $392,311 and $124,919 for income taxes during the nine months ended May 31, 2006 and 2005, respectively.

- The Company issued 349,368 and 75,000 stock options during the nine month periods ended May 31, 2006 and 2005, respectively, which resulted in an increase to deferred compensation of $363,200 and $15,750, respectively.

- The Company had an income tax benefit from the exercise of stock options of $972,282 and $230,182 during the nine months ended May 31, 2006 and 2005, respectively, which was recorded as an increase to additional paid-in capital and a reduction in income taxes payable.

- The Company had an unrealized loss of $115,305 during the nine months ended May 31, 2006 on available-for-sale securities.

BSD MEDICAL CORPORATION
Notes to Condensed Financial Statements

Note 1. Basis of Presentation

The accompanying unaudited condensed financial statements of BSD Medical Corporation as of May 31, 2006 and for the three and nine months ended May 31, 2006 and 2005, 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 (SEC). The financial statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. These financial statements should be read in conjunction with the notes hereto, and the financial statements and notes thereto included in our annual report on Form 10-KSB for the year ended August 31, 2005.

All adjustments (consisting only of normal recurring adjustments) necessary for the fair presentation of our financial position as of May 31, 2006 and our results of operations, financial position and changes therein for the three and nine months ended May 31, 2006 and 2005 have been included. The results of operations for the three and nine months ended May 31, 2006 may not be indicative of the results for the year ending August 31, 2006.

Note 2. Recent Accounting Pronouncements

The Company accounts for stock-based compensation awards issued to employees using the intrinsic value measurement provisions of Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees for Stock-Based Compensation. Accordingly, no compensation expense has been recorded for stock options granted to employees with exercise prices greater than or equal to the fair value of the underlying common stock at the option grant date. On December 16, 2004, the Financial Accounting Standards Board (FASB) issued Statements of Accounting Standards (SFAS) No. 123R (revised 2004), Share-Based Payment, which eliminates the alternative of applying the intrinsic value measurement provisions of APB No. 25 to stock compensation awards issued to employees. The new standard requires enterprises to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period).

The Company has not yet quantified the effects of the adoption of SFAS 123R, but it is expected that the new standard will result in significant stock-based compensation expense. The pro forma effects on net loss and net loss per common share if the Company had applied the fair value recognition provisions of the original SFAS 123 on stock compensation awards (rather than applying the intrinsic value measurement provisions of APB 25) are disclosed in Note 6 below. Although the pro forma effects of applying the original SFAS 123 may be indicative of the effects of adopting SFAS 123R, the provisions of these two statements differ in some important respects. The actual effects of adopting SFAS 123R will be dependent on numerous factors including, but not limited to, the valuation model chosen by the Company to value stock-based awards, the assumed award forfeiture rate, the accounting policies adopted concerning the method of recognizing the fair value of awards over the requisite service period, and the transition method (as described below) chosen for adopting SFAS 123R.

SFAS 123R will be effective for the Company beginning September 1, 2006, and requires the use of either the Modified Prospective Application Method or the Modified Retrospective Method. Under the Modified Prospective Method, SFAS 123R is applied to new awards and to awards modified, repurchased, or cancelled after the effective date. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered (such as unvested options) that are outstanding as of the date of adoption shall be recognized as the remaining requisite services are rendered. The compensation cost relating to unvested awards at the date of adoption shall be based on the grant-date fair value of those awards as calculated for pro forma disclosures under the original SFAS 123. Alternatively, companies may use the Modified Retrospective Application Method. This method may be applied to all prior years for which the original SFAS 123 was effective or only to prior interim periods in the year of initial adoption. If the Modified Retrospective Application Method is applied, financial statements for prior periods shall be adjusted to give effect to the fair-value-based method of accounting for awards on a consistent basis with the pro forma disclosures required for those periods under the original SFAS 123.

On April 15, 2005, the SEC issued Release No. 33-8568, Amendment to Rule 4-01(a) of Regulation S-X Regarding the Compliance Date for SFAS 123R. The amended rule permits calendar year registrants subject to oversight by the SEC to implement SFAS 123R at the beginning of its next fiscal year. The Company will implement SFAS 123R at the beginning of its next fiscal year (September 1, 2006).

In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107 Share-Based Payment to simplify some of the implementation challenges of SFAS 123R. In particular, SAB 107 provides supplemental implementation guidance on SFAS 123R including guidance on valuation methods, classification of compensation expense, inventory capitalization of share-based compensation costs, income tax effects, disclosures in Management's Discussion and Analysis and several other issues. We will apply the principles of SAB 107 in conjunction with the adoption of SFAS 123R.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, which replaces APB No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS 154 applies to all voluntary changes in accounting principle, and changes the requirements for accounting and reporting a change in accounting principles. SFAS 154 requires retroactive application to prior periods' financial statements of a voluntary change in accounting principle unless it is impractical to do so. APB 20 previously required that most voluntary changes in accounting principle be recognized with a cumulative effect adjustment in net income of the period of the change. SFAS 154 is effective for accounting changes made in annual periods beginning after December 15, 2005. The Company will implement SFAS 154 at the beginning of its next fiscal year (September 1, 2006) and does not expect it to have a material effect on its financial position, results of operations or cash flows.

Note 3. Net Income 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 outstanding using the treasury stock method and the average market price per share during the period. When common stock equivalents are anti-dilutive, they are not included.

The shares used in the computation of the Company's basic and diluted earnings per share are reconciled as follows:

	Three Months Ended May 31,		Nine Months E May 31,
	2006	2005	2006
Weighted average number of shares outstanding - basic	20,926,000	20,144,000	20,683,000
Dilutive effect of stock options	1,237,000	468,000	1,465,000
Weighted average number of shares outstanding - diluted	22,163,000	20,612,000	22,148,000

Note 4. Inventories

Inventories consisted of the following as of May 31, 2006:

Raw materials	$ 810,728
Work in process	787,482
Reserve for obsolete inventory	(80,000)
	$ 1,518,210

Note 5. Related Party Transactions

During the nine months ended May 31, 2006 and May 31, 2005, the Company had sales of $669,041 and $539,431, respectively, to an entity controlled by a significant stockholder and member of the Board of Directors. These related party transactions represent 39.98% and 40.29% of total sales for the corresponding period. During the three months ended May 31, 2006 and May 31, 2005 the Company had related party sales of $448,721 and $43,370, respectively, which represent 62.95% and 11.87% of total sales for the corresponding period.

Note 6. Stock-Based Compensation

The Company accounts for stock options granted to employees under the recognition and measurement principles of APB 25, Accounting for Stock Issued to Employees, and related Interpretations, and has adopted the disclosure-only provisions of SFAS No. 123, Accounting for Stock-Based Compensation. Accordingly, the difference between the exercise price and the fair market value of the stock on the grant date has been recognized in the financial statements as expense. Had the Company's stock options been accounted for based on the fair value method of SFAS No. 123, the results of operations would have been reduced to the pro forma amounts indicated below for the periods indicated below:

	Three Months Ended May 31,	Nine M M

	2006	2005	2006
Net income as reported	$ 2,987,623	$ 2,948,795	$ 9,305,54
Add: Stock based employee compensation expense included in reported net income net of related tax effects	$ -	-	75,95
Deduct: Total stock based employee compensation expense determined under fair value based method for all awards, net of related taxes	$ (6,377)	(50,926)	(177,17
Net income - pro forma	$ 2,981,246	$ 2,897,869	$ 9,204,32
Basic income per share as reported	$ .14	$ .15	$ .4
Diluted income per share as reported	$ .13	$ .14	$ .4
Basic income per share - pro forma	$ .14	$ .14	$ .4
Diluted income per share - pro forma	$ .13	$ .14	$ .4

The fair value of each stock option granted for the nine months ended May 31, 2006 and 2005 is estimated on the date of grant using the Black-Scholes option pricing model using the following assumptions:

	2006	2005
Expected dividend yield	$ -	$ -
Expected stock price volatility	75%	81%
Risk-free interest rate	4.3%	3.32%
Expected life of options	4.89 years	7 years

The weighted average fair value of options granted during the nine months ended May 31, 2006 and 2005 was $3.53 and $1.97, respectively.

Note 7. Gain on Sale of Investment in TherMatrx

On July 15, 2004, the Company's investment in an unconsolidated subsidiary (TherMatrx) was sold to American Medical Systems, Inc. (AMS). The Company's portion of the initial payment from this sale, received in fiscal 2004, was approximately $9 million, with additional payments contingent on the quarterly sales of TherMatrx through the fourth calendar quarter of 2005. During the quarter ended May 31, 2006, the Company received an additional payment from the sale of TherMatrx of $5,863,222 to bring the total received to date as of May 31, 2006 to $32,940,174. This amount is recorded as a gain and has been reflected as "other income" in the Statements of Operations.

Note 8. Stockholders' Equity

During the nine months ended May 31, 2006, 656,598 shares of common stock were issued for cash of $415,036 and services of $48,471.

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 subsections entitled "Forward-Looking Statements" below. The following discussion should be read in conjunction with our consolidated 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.

General

We develop, manufacture, market and service systems that deliver precision-focused radio frequency (RF) and microwave energy into diseased sites of the body, heating them to specified temperatures as required by a variety of medical therapies. Our business objectives currently are to commercialize our products developed for the treatment of cancer and to further expand our developments to treat other diseases and medical conditions.

While our primary developments to date have been cancer treatment systems, we also pioneered the use of microwave thermal therapy for the treatment of symptoms associated with enlarged prostate, and we are responsible for much of the technology that has successfully created a substantial new medical industry using that therapy. In accordance with our strategic plan, we sold our interest in TherMatrx, Inc., the company established to commercialize our technology to treat enlarged prostate symptoms, to provide funding that we can utilize for commercializing our systems used in the treatment of cancer and in achieving other business objectives. We have received approximately $33 million in earnout payments from the TherMatrx sale through May 31, 2006.

In spite of the advances in cancer treatment technology, over 40% of cancer patients continue to die from the disease in the United States, and cancer has now surpassed heart disease as the number one killer from all causes of death in the United States. Commercialization of our systems used to treat cancer (the BSD-2000 and BSD-500 families of products) is our most immediate business objective. Our cancer therapy systems are used in combination with existing cancer treatments to kill cancer with heat while boosting the effectiveness of radiation and chemotherapy through a number of biological mechanisms. Current and targeted cancer treatment sites for our systems include cancers of the prostate, breast, chestwall, head, neck, bladder, cervix, colon/rectum, esophagus, liver, pancreas, brain, bone, stomach and lung, including soft tissue sarcoma, melanoma, carcinoma, and basal cell carcinoma.

Our BSD-2000 systems are used to non-invasively treat cancers located deeper in the body, and are designed to be companions to the estimated 7,500 linear accelerators used to treat cancer through radiation globally and in combination with chemotherapy treatments. Our BSD-500 systems treat cancers on or near the body surface and those that can be approached through body orifices such as the throat, the rectum, etc., or through interstitial treatment in combination with interstitial radiation (brachytherapy). BSD-500 systems can be used as companions to our BSD-2000 systems, to the estimated 2,500 brachytherapy systems installed and with chemotherapy treatments.

We have received FDA approval to market our commercial version of the

BSD-500 and have applied for FDA approval to sell the BSD-2000 in the United States. We have designed our cancer treatment systems such that together they are capable of providing complementary therapy for treatment of most solid tumors located in the body.

In this report it will be noted that we have substantially increased our emphasis on marketing, market preparation and sales efforts. This corresponds to our FDA submission for approval of the BSD-2000. Our objective is to prepare the market for our systems. We have also increased our efforts in the development of new products.

We now have five outside sales people in the United States and a Vice President of Sales whose role is to prepare and develop markets for our cancer treatment systems. We are also attending major trade shows as well as advertising in journals and magazines. On an international basis, we are formulating sales distribution relationships. Multiple supportive marketing efforts are also being used behind these initiatives.

Our market research has shown that when patients are informed about our cancer therapy there is a strong propensity for them to pursue it with their physician. We have therefore initiated an internet website program focused on cancer patients and caregivers. This website can be accessed at www.treatwithheat.com. In conjunction with the patient website, a patient advisor hotline has been created to allow patients to call and discuss the therapy. We have also developed education materials that are sent to those that request it. These materials better prepare patients to discuss the treatment with their physicians.

We are completing a website directed at the physicians who currently provide, or who are candidates to provide the therapy. The primary objective of this website is to provide physician training.

We are conducting a public relations campaign directed at national press coverage via television and newspapers, as well as magazines and journals. This campaign has already reached out to more than 20 million people in all 50 states, as well as internationally.

To bring further patient attention to our cancer therapy, we have developed a special website focused on cancer patients and their need for emotional support from family and friends. The "Hope Garden" allows patients and supporters to "plant flowers" with messages of hope attached and then Emailed to the patient. The flower is then planted in the cyber-space garden where all can view the messages of hope and inspiration. This website can be accessed at www.flowersforhope.com.

Our common stock trades on the American Stock Exchange (AMEX) under the symbol "BSM."

Our accumulated deficit since inception decreased from $8,751,454 as of August 31, 2005 to a positive retained earnings of $554,091 as of May 31, 2006 due to a positive net income recorded during the nine months ended May 31, 2006. We recorded after tax net income for the first nine months of fiscal 2006 of $9,305,545.

We recognize revenue from the sale of cancer treatment systems, the sale of parts and accessories related to the cancer treatment systems, the sale of software license rights, providing manufacturing services, training and support services. Product sales were $1,554,246 and $1,189,824 for the nine months ended May 31, 2006 and 2005, respectively. Service revenue was $119,067 and $148,736 for the nine months ended May 31, 2006 and 2005, respectively.

During the nine month period ended May 31, 2006, we earned $1,004,272, or 61%, of our revenue from sales to unrelated parties. These revenues consisted of product sales of $886,954, consulting services of $89,268 and service contracts of $28,050.

Cost of sales for the period ended May 31, 2006 includes raw materials and labor costs of $751,089 and overhead costs of $322,855. Research and development expenses include expenditures for new product development and development of enhancements to existing products.

Critical Accounting Policies and Estimates

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 cancer treatment 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. We provide a reserve allowance for estimated returns. To date, returns have not been significant.

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

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. As of May 31, 2006, we have a reserve for potential inventory impairment recorded of $80,000. We periodically review our inventory levels and usage, paying particular attention to slower-moving items.

Product Warranty. We provide product warranties on our BSD-500 and

BSD-2000 systems. These warranties vary from contract to contract, but generally consist of parts and labor warranties for one year from the date of sale. 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 provide our customers with payment terms that vary from contract to contract. Our allowance for doubtful accounts at May 31, 2006 was $42,500. Bad debt expense for the nine months ended May 31, 2006 was $0. We perform ongoing credit evaluations of our customers and maintain allowances for possible losses. Allowance estimates are recorded on a customer-by-customer basis and are determined based on the age of the receivable, compliance with payment terms, and prior history with existing clients.

Results of Operations

Three Months Ended May 31, 2006 Compared to the Three Months Ended May 31, 2005

Revenue. Revenue for the three months ended May 31, 2006 was $712,771 compared to $365,213 for the three months ended May 31, 2005, an increase of $347,558, or approximately 95%. The increase in total revenue was primarily due to an increase in sales to related parties.

We derived $448,721, or approximately 63%, of our revenue in the three months ended May 31, 2006 from sales to related parties as compared to $43,370, or 12%, in the three months ended May 31, 2005. All of the related party revenue in the three months ended May 31, 2006 was from sales of systems and component parts to Medizin-Technik GmbH. Dr. Gerhard Sennewald, one of our directors, is a stockholder, executive officer and a director of Medizin0-Tehcnik. Sales to Medizin-Technik may fluctuate significantly from period to period because our sales, to date, have been based upon a relatively small number of 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 systems can cause a large change in the revenue from period to period.

In the three months ended May 31, 2006, we derived $264,050, or 37%, of our revenue from sales to unrelated parties, as compared to $321,843, or 88%, for the three months ended May 31, 2005.

Gross Profit. Gross profit for the three months ended May 31, 2006 was $300,056, or 42% as compared to $61,753, or 17% of total product sales for the three months ended May 31, 2005. This increase in gross profit margin was attributed to the improved production efficiencies and higher sales.

Selling General and Administrative Expenses. Selling, general and administrative expenses increased to $1,329,282 in the three months ended May 31, 2006, up from $504,923 for the three months ended May 31, 2005, an increase of $824,359, or 163%. This increase was primarily due to an increase in sales and marketing costs of $862,110 supporting sales and marketing preparation efforts as described above.

Research and Development Expenses. Research and development expenses were $380,623 for the three months ended May 31, 2006, as compared to $270,803 for the three months ended May 31, 2005, an increase of $109,820, or 41%, primarily due to an increase in payroll and consulting costs associated with increased emphasis on the development of new products.

Interest income. Interest income increased to $411,777 for the three months ended May 31, 2006, as compared to $43,306 for the three months ended May 31, 2005, due to the significantly higher levels of cash and available-for-sale securities resulting from the sale of our investment in TherMatrx.

Net income. Net income for the three months ended May 31, 2006 was $2,987,623 after an income tax expense of $1,949,621, as compared to net income of $2,948,795 for the three months ended May 31, 2005. The increase in the net income was substantially due to a payment of $5,863,222 received during the period ended May 31, 2006, from the sale of our investment in TherMatrx, and the increase in interest income.

Results of Operations

Nine Months Ended May 31, 2006 Compared to the Nine Months Ended May 31, 2005

Revenue. Revenue for the nine months ended May 31, 2006 was $1,673,313, compared to $1,338,560 for the corresponding period in fiscal 2005, an increase of $334,753 or approximately 25%. The increase in total revenue was primarily due to an increase in sales to related and non-related parties.

In the nine months ended May 31, 2006, we derived $669,041, or 40% of our revenue, as compared to $539,431, or 40% of our revenue, in the nine months ended May 31, 2005, from sales to related parties. All of the related party revenue in the nine months ended May 31, 2006, was from sales of BSD systems and

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component parts to Medizin-Technik. Dr. Gerhard Sennwald, one of our directors is a stockholder, executive officer and a director of Medizin-Tehcnik. Sales to Medizin-Technik may fluctuate significantly from period to period due to the relatively high price of a BSD-2000 or BSD-500 system to the sales volume. Sales increases of one or two systems can have a material effect on our revenue.

In the nine months ended May 31, 2006, we derived $1,004,272, or 60% of our revenue to sales to non-related parties compared to $799,129, or 60% for the corresponding period of fiscal 2005. Our fiscal 2006 non-related party revenue consisted of product sales of approximately $ 886,954. The balance of our non-related party revenue consisted of consulting services of approximately $89,268 and service contracts of approximately $28,050.

Gross Profit. Gross profit for the nine months ended May 31, 2006 was $599,369, or 36% as compared to $389,770, or 29% of sales in the corresponding period in fiscal 2005. The increase in gross profit margin was primarily due to the efficiencies afforded through the increase of sales.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased to $3,553,103 in the nine months ended May 31, 2006, from $1,343,619 for the corresponding period of fiscal 2005, an increase of $2,209,484, or 165%. Our sales and marketing costs increased from approximately $419,370 in the nine months ended May 31, 2005 to approximately $2,065,728 in the nine months ended May 31, 2006 due to increased number of sales people and to higher sales and marketing costs due to greater emphasis on sales and marketing as described above in our management discussion in Item 2. Legal and accounting costs increased from approximately $113,498 in the 2005 period to approximately $193,537 in the 2006 period, reflecting the use of legal counsel in preparation for the shareholders meeting and the review of the Form 10-QSB, 10-KSB and proxy statements, as well as fees incurred in connection with tax consulting and planning. Shareholder relations costs increased from approximately $54,838 in the 2005 period to approximately $82,077 in the 2006 period reflecting costs incurred in connection with our annual shareholders meeting and the issuance of various press releases. Consulting costs increased from approximately $109,713 to approximately $171,959 from the 2005 period to the 2006 period, respectively. This was due to the use of consultants in efforts to file the FDA application for the BSD 2000.

Research and Development Expenses. Research and development expenses were $945,527 for the nine months ended May 31, 2006, as compared to $645,683 for the corresponding period in fiscal 2005, an increase of $299,844, or 46%, primarily due to an increase in payroll and consulting costs associated with increased emphasis on the development of new products and costs associated with filing the FDA application for the BSD 2000.

Interest income. Interest income increased to $960,990 in the nine months ended May 31, 2006 as compared $200,804 for the nine months ended May 31, 2005, due to the higher levels of cash on hand resulting from the sale of our shares in TherMatrx.

Net income. Net income after taxes for the nine months ended May 31, 2006, was $9,305,545 as compared with a net income of $3,315,663 for the corresponding period of fiscal 2005. The increase in the net income was significantly due to payments of $17,413,342 during the 2006 period from the sale of our shares in TherMatrx and the increase in interest income.

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 market acceptance of our cancer therapy systems, changes in the medical capital equipment market, changes in order mix and product order configurations, competition, regulatory developments and other matters. Operating expenses may fluctuate as a result of the timing of sales and marketing activities, research and development and clinical trial expenses, 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.

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Liquidity and Capital Resources

Our accumulated deficit since inception decreased from $8,751,454 as of August 31, 2005 to a positive retained earnings of $554,091 as of May 31, 2006 due to net income recorded during the nine months ended May 31, 2006. We recorded after tax net income for the first nine months of fiscal 2006 of $9,305,545

We have received additional payments and expect to receive a final payment as a result of the sale of our TherMatrx shares. In accordance with the purchase agreement, we expect to receive a final adjustment payment in American Medical System's third quarter which ends approximately September 30, 2006 for cash collected on open receivables at the end of the earnout period.

During the nine months ended May 31, 2006, we used $3,229,031 in operating activities. The cash used in operating activities was mainly the result of the exclusion of TherMatrx gain, an increase in income taxes payable of $4,998,125, an increase in accounts payable of $411,138, an increase in accrued expenses of $221,055, an increase in accounts receivable of $441,505, and an increase in inventory of $383,857. Our investing activities for the nine months ended May 31, 2006 generated net cash of $2,447,767, relating mainly to the proceeds received from the sale of our investment in TherMatrx of $17,413,342 offset by the purchase of available-for-sale securities of $14,770,709 and the purchase of certain property and equipment of $194,866. Total cash decreased from $908,674 at August 31, 2005 to $542,446 at May 31, 2006, primarily as a result of cash used in operations and an increase in investments.

We expect to use the payments from the sale of our TherMatrx shares, including any contingent payments, for general corporate purposes, including the sales and marketing effort for our FDA approved cancer therapy products, supporting the FDA application for our cancer therapy products, the development of new products used in medical therapy and the possible acquisition of new companies or technology.

We expect to incur additional expenses related to the commercial introduction of our systems, due to additional participation at trade shows, expenditures on publicity, additional travel, increased sales salaries and commissions and other related expenses. In addition, we anticipate that we will incur increased expenses related to seeking governmental and regulatory approvals for our products, during fiscal 2006 in excess of fiscal 2005.

We believe our current cash and cash equivalents and securities that are available for sale will be sufficient to finance our operations through fiscal 2006.

FORWARD-LOOKING STATEMENTS

With the exception of historical facts, the statements contained in sections entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" 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 anticipated financial performance and business plan;
- our expectations regarding the commercial introduction of our systems;
- our expectations and efforts regarding receipt of FDA approvals relating to the BSD-2000 system;
- our technological developments for the BSD-500 and BSD-2000 systems;

- our ability to successfully develop our technology for new applications and the expense of such developments;
- our development or acquisition of new technologies;
- the amount of expenses we will incur for the commercial introduction of our systems;
- our anticipation that we will incur increased expenses related to

seeking governmental and regulatory approvals for our products during fiscal 2006 in excess of fiscal 2005;

- our expectation that related party revenue will continue to be a significant portion of our total revenue;
- our belief that sales of BSD-500 and BSD-2000 systems will increase through our future sales and marketing efforts;
- our belief that payments received in connection with the sale of our TherMatrx shares will contribute to our future capital resources;
- our anticipated use of proceeds from the sale of our TherMatrx shares; and
- our belief that our current cash, investments and cash received from the sale of our TherMatrx shares will be sufficient to finance our operations through fiscal 2006.

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 the section entitled "Risk Factors" included in our Annual Report on Form 10-KSB for the year ended August 31, 2005 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. Controls and Procedures

a. Evaluation of disclosure controls and procedures.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated 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 (the "Exchange Act"). Based upon that 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 not effective and adequately designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in applicable rules and forms. We have identified deficiencies that existed in the design or operation of our internal control over financial reporting. The deficiencies relate to the preparation of our provision for income taxes and related income tax footnote disclosures, and the lack of formal procedures to identify and apply new accounting pronouncements and related disclosures. These deficiencies were detected in the review process and have been appropriately recorded and disclosed in this Form 10-QSB. We are in the process of improving our internal control and related disclosures in an effort to remediate these deficiencies through improved supervision and training of our accounting staff. These deficiencies have been disclosed to our audit committee and to our auditors. Additional effort is needed to fully remedy these deficiencies and we are continuing our efforts to improve and strengthen our control processes and procedures. Our management, audit committee, and directors will continue to work with our auditors and other outside advisors to ensure that our controls and procedures are adequate and effective.

b. Changes in internal controls.

During the fiscal quarter covered by this report, there has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) or 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None.

Item 6. Exhibits

The following exhibits are filed as part of this report:

Exhibit No.	Description of Exhibit
31.1	Certification Required Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification Required Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification Required Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification Required Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

BSD MEDICAL CORPORATION

Date: July 17, 2006

/s/ Hyrum A. Mead

President (principal executive officer)

Date: July 17, 2006

/s/ Dennis E. Bradley

Controller (principal financial officer)