BSD MEDICAL CORP
Form 10-Q
January 16, 2007

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended November 30, 2006

|_| 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. 0-10783

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

Delaware	75-1590407
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer |_| Accelerated Filer |_| Non-accelerated Filer |X|

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

As of January 15, 2007, there were 21,040,186 shares of the registrant's common stock, $0.001 par value per share, outstanding

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

BSD MEDICAL CORPORATION
Condensed Balance Sheets
(Unaudited)

Assets	November 30, 2006	August 31, 2006
Current assets:		
Cash and cash equivalents	$ 1,273,927	$ 2,179,094
Investments	20,920,220	22,556,106
Receivables, net	1,086,886	1,186,800
Related party trade receivables	226,683	261,543
Income tax receivable	328,021	-
Inventories, net	1,474,247	1,366,264
Deferred tax asset	279,000	178,000
Other current assets	112,309	120,277
Total current assets	25,701,293	27,848,084
Property and equipment, net	306,199	303,034
Note receivable	137,500	137,500
Patents, net	20,781	21,250
	$ 26,165,773	$ 28,309,868

Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	$ 490,256	$ 365,396
Accrued liabilities	423,982	545,113
Income taxes payable	-	1,539,946
Deferred revenue - current portion	23,293	17,912
Total current liabilities	937,531	2,468,367
Deferred revenue - less current portion	200,833	217,500
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.001 par value; 10,000,000 authorized, no shares issued and outstanding	-	-
Common stock, $.001 par value; 40,000,000 shares authorized; 21,040,186 and 21,023,668 shares issued and outstanding	21,041	21,024
Additional paid-in capital	25,438,724	25,452,231

Deferred compensation	-	(247,700)
Treasury stock , at cost	(234)	(234)
Other comprehensive loss	(68,493)	(99,362)
Retained earnings (deficit)	(363,629)	498,042
Total stockholders' equity	25,027,409	25,624,001
	$ 26,165,773	$ 28,309,868

See accompanying notes to condensed financial statements.

BSD MEDICAL CORPORATION

Condensed Statements of Operations
(Unaudited)

	Three Months Ended November 30,	
	2006	2005
Revenues:		
Sales	$ 648,611	$ 509,881
Sales to related parties	16,044	11,286
Total revenues	664,655	521,167
Costs and expenses:		
Cost of sales	436,625	352,244
Cost of sales to related parties	12,630	5,256
Research and development	332,079	230,165
Selling, general and administrative	1,556,441	1,054,114
Total costs and expenses	2,337,775	1,641,779
Operating loss	(1,673,120)	(1,120,612)
Other income (expense):		
Interest income	370,213	244,623
Other income (expense)	(27,732)	5,882,925
Total other income	342,481	6,127,548
Income (loss) before income taxes	(1,330,639)	5,006,936
Income tax benefit (expense)	468,968	(1,870,694)
Net income (loss)	$ (861,671)	$ 3,136,242
Net income (loss) per common share - basic	$ (.04)	$ .15

Net income (loss) per common share - diluted	$ (.04)	$ .13
Weighted average number of common shares outstanding		
Basic	21,036,000	20,513,000
Diluted	21,036,000	22,145,000

See accompanying notes to condensed financial statements.

BSD MEDICAL CORPORATION

Condensed Statements of Cash Flows
(Unaudited)

	Three Months Ended November 30, 2006	Three Months Ended November 30, 2005
Cash flows from operating activities:		
Net income (loss)	$ (861,671)	$ 3,136,242
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Provision for doubtful accounts	83,700	-
Depreciation and amortization	21,116	34,309
Stock compensation expense	234,210	945
Gain on sale of investment in TherMatrx	-	(5,882,925)
Amortization of deferred compensation	-	36,650
(Increase) decrease in:		
Receivables	16,214	(332,197)
Related party receivables	34,860	210,756
Income tax receivable	(367,967)	-
Inventories	(107,983)	(156,866)
Deferred tax asset	(101,000)	(8,000)
Other current assets	7,968	(22,751)
Increase (decrease) in:		
Accounts payable	124,860	234,432
Accrued expenses	(121,131)	105,296
Income taxes payable	(1,500,000)	1,770,602
Deferred revenue	(11,286)	(2,894)
Net cash used in operating activities	(2,548,110)	(876,401)
Cash flows from investing activities:		
Proceeds from sale of investment in TherMatrx	-	5,882,925
(Purchase) sale of investments	1,666,755	(5,698,833)
Purchase of property and equipment	(23,812)	(133,435)

Net cash provided by investing activities	1,642,943	50,657
Cash flows from by financing activities:		
Proceeds from sale of common stock	-	75,305
Decrease in cash and cash equivalents	(905,167)	(750,440)
Cash and cash equivalents, beginning of period	2,179,094	908,674
Cash and cash equivalents, end of period	$ 1,273,927	$ 158,235

Supplemental Disclosure of Cash Flow Information

- The Company paid no cash for interest during the three months ended November 30, 2006 and 2005 and $1,500,000 and $108,091 for income taxes during the three months ended November 30, 2006 and 2005, respectively.

- The Company issued 120,000 stock options during the three months ended November 30, 2006, which resulted in compensation expense of $344,141 of which $17,207 was recognized during the quarter. The Company issued

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170,000 stock options during the three months ended November 30, 2005, which resulted in an increase to deferred compensation of $326,550.

- The Company had an income tax benefit from the exercise of stock options of $258,892 during the three months ended November 30, 2005, which was recorded as an increase to additional paid-in capital and a reduction in income taxes payable.

- The Company had an unrealized gain of $30,869 during the three months ended November 30, 2006 on available-for-sale securities. The Company had an unrealized loss of $61,478 during the three months ended November 30, 2005 on available-for- sale securities.

- The Company transferred deferred compensation of $247,700 to additional paid-in capital during the three months ended November 30, 2006.

- The Company decreased income taxes payable and decreased income tax receivable by $39,946 during the three months ended November 30, 2006.

See accompanying notes to condensed financial statements

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BSD MEDICAL CORPORATION
Notes to Condensed Financial Statements

Note 1. Basis of Presentation

The accompanying unaudited condensed balance sheets of BSD Medical Corporation as of November 30, 2006 and August 31, 2006 and the related unaudited condensed statements of operations and of cash flows for the three months ended November 30, 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 condensed financial statements do not include all of the information and footnotes 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-KSB for the year ended August 31, 2006.

All adjustments (consisting only of normal recurring adjustments) necessary for the fair presentation of our financial position as of November 30, 2006 and August 31, 2006 and our results of operations and cash flows for the three months ended November 30, 2006 and 2005 have been included. The results of operations for the three months ended November 30, 2006 may not be indicative of the results for the year ending August 31, 2007.

Note 2. Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) 48, Accounting for Uncertainty in Income Taxes. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. We are currently evaluating the impact this Interpretation will have on our financial statements. This Interpretation will be effective in the Company's financial statements for the fiscal year beginning September 1, 2007.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy as defined in the standard. Additionally, companies are required to provide enhanced disclosure regarding financial instruments in one of the categories, including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We believe that the adoption of SFAS No. 157 will not have a material impact on the financial statements.

The FASB has issued Statement No. 154, Accounting Changes and Error Corrections. This new standard replaces Accounting Principles Board (APB) Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in the Interim Financial Statements. Among other changes, SFAS No. 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statement presented on the new accounting principle, unless it is impracticable to do so. SFAS No. 154 also provides that (1) a change in method of depreciating or amortizing a long-lived non-financial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and (2) correction of errors in previously issued financial statement should be termed a "restatement." The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. Early adoption of this standard is permitted for accounting changes and correction of errors made in fiscal years beginning after June 1, 2005. The adoption of this new accounting pronouncement had no material impact on the Company's financial position or results of operations.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Instruments, which amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. SFAS No. 155 also clarifies and amends certain other provisions of SFAS No. 133 and SFAS No. 140. This statement is effective for all financial instruments acquired or issued in financial years beginning after September 15, 2006. We do not expect our adoption of this new standard to have a material impact on our financial position, results of operations or cash flows.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets to simplify accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. Additionally, SFAS No. 156 applies to all separately recognized servicing assets and liabilities acquired or issued after the beginning of an entity's fiscal year that begins after September 15, 2006, although early adoption is permitted. We do not expect our adoption of this new standard to have a material impact on our financial position, results of operations or cash flows.

Note 3. Net Income (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 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. During the three months ended November 30, 2006, 1,174,999 common stock equivalents related to stock options were not included in the computation due to their anti-dilutive effect.

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

	Three Months Ended November 30,	
	2006	2005
Weighted average number of shares outstanding - basic	21,036,000	20,513,000
Dilutive effect of stock options	-	1,632,000
Weighted average number of shares outstanding - diluted	21,036,000	22,145,000

Note 4. Inventories

Inventories consist of the following:

	November 30, 2006	August 31, 2006
Parts and supplies	$ 867,804	$ 711,552
Work-in-process	593,339	641,608
Finished goods	53,104	53,104
Reserve for obsolete inventory	(40,000)	(40,000)
Inventories, net	$ 1,474,247	$ 1,366,264

Note 5. Related Party Transactions

During the three months ended November 30, 2006 and November 30, 2005, we had sales of $16,044 and $11,286, respectively, to an entity controlled by a significant stockholder and member of the Board of Directors. These related party transactions represent 2% of total sales for each period.

At November 30, 2006 and August 31, 2006, receivables include $226,683 and $261,543 respectively, from this entity.

Note 6. Stock-based compensation

On September 1, 2006, we adopted SFAS No. 123 (R), Share-Based Payment, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee stock options. In accordance with this standard, we recognize the compensation cost of all share-based awards on a straight-line basis over the requisite service period for the number of awards that are expected to vest. Prior to September 1, 2006, we accounted for those plans under the recognition and measurement provisions of APB Opinion No. 25, and related Interpretations, as permitted by SFAS No. 123.

Our condensed financial statements as of November 30, 2006 and for the three months ended November 30, 2006 reflect the impact of the implementation of SFAS 123(R). We adopted SFAS 123(R) using the modified prospective transition method, which requires that compensation expense be recognized during the quarter ended November 30, 2006 equal to: (a) amortization related to the compensation cost for all share-based payments granted prior to, but not yet vested as of September 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (b) amortization related to compensation cost for all share-based payments granted subsequent to September 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). Results for prior periods have not been restated.

We have two stock-based employee plans and a director option plan which are described more fully in Note 11 in our 2006 Annual Report on Form 10-KSB. As of November 30, 2006, we had approximately 779,000 shares of common stock reserved for future issuance under the stock option plans.

The adoption of SFAS 123(R) had a significant impact on our results of operations. Our statement of operations for the three months ended November 30, 2006 includes stock-based compensation expense from stock options of $204,210 in selling, general and administrative expenses.

During the three months ended November 30, 2006, we granted 120,000 options to our directors, with one fifth vesting each year for the next five years. This grant accounts for $17,207 of the stock-based compensation expense for the three months ended November 30, 2006.

Unrecognized stock-based compensation expense expected to be recognized over the estimated weighted-average amortization period of 1.34 years is approximately $1,671,000 at November 30, 2006.

Our weighted-average assumptions used in the Black-Scholes valuation model for equity awards with time-based vesting provisions granted during the three months ended November 30, 2006 are shown below:

Expected volatility	67.57%
Expected dividends	0%
Expected term	5 Years
Risk-free interest rate	4.68%

The expected volatility rate was estimated based on the historical volatility of our common stock. The expected term was estimated based on historical experience of stock option exercise. The risk-free interest rate is the rate provided by the U.S. Treasury for Daily Treasury Yield Curve Rates commonly referred to as "Constant Maturity Treasury" rate in effect at the time of grant with a remaining term equal to the expected option term.

The following table illustrates the effect on net loss and loss per share if we had applied the fair value recognition provisions of Statement 123 to options granted under our stock option plans and the employee stock purchase plan for the three months ended November 30, 2005. For purposes of this pro-forma disclosure, the value of the options is estimated using a Black-Scholes option-pricing model and charged to expense over the options' vesting periods.

Net income - as reported	$	3,136,242
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects		36,650
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of related taxes fair value based method for all awards, net of related taxes		(158,738)
Net income - pro forma	$	3,014,154
Income per common share - as reported:		
Basic	$	.15
Diluted	$	.13
Income per common share - pro forma:		
Basic	$	.14
Diluted	$	.13

A summary of the time-based stock option awards as of November 30, 2006, and changes during the three months then ended, is as follows:

Stock Option Awards	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contract Term (Years)	Aggregate Intrinsic Value
Outstanding at August 31, 2006	1,809,051	$ 1.72		
Granted	120,000	4.77		
Exercised	13,788	1.31		
Forfeited or expired	-	-		
Outstanding at November 30, 2006	1,915,263	$ 1.92		
Exercisable at November 30, 2006	1,331,309	$ 1.24	6.32	$ 6,604,000

The weighted-average grant-date fair value of stock options granted during the three months ended November 30, 2006 was $4.77.

Upon adoption of SFAS No. 123 (R) on September 1, 2006, we closed the balance of deferred compensation of $247,700 to additional paid-in capital.

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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

BSD Medical Corporation develops, manufactures, markets and services medical systems that deliver precision-focused radio frequency (RF) or microwave energy into diseased sites of the body, heating them to specified temperatures as required by a variety of medical therapies. Our business objectives are to commercialize our products developed for the treatment of cancer and to further expand our developments to treat other diseases and medical conditions. Our product line for cancer therapy has been created to offer hospitals and clinics a complete solution for thermal treatment of cancer as provided through microwave/RF systems.

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 subsequently sold our interest in TherMatrx, Inc., the company established to commercialize our technology to treat enlarged prostate symptoms, to provide substantial funding that we can utilize for commercializing our systems used in the treatment of cancer and in achieving other business objectives.

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, including the BSD-2000 and BSD-500 families of systems and the new MicroThermX 100 microwave thermal ablation system, is our most immediate business objective. Our BSD-2000 and BSD-500 cancer treatment systems are used to treat cancer with heat while boosting the effectiveness of radiation and chemotherapy through a number of biological mechanisms. Our MicroThermX 100 system is used to treat cancers with heat alone. Current and targeted cancer treatment sites for our systems include cancers of the prostate, breast, head, neck, bladder, cervix, colon/rectum, esophagus, liver, brain, bone, stomach and lung, and including general pelvic and abdominal tumors. Our cancer treatment systems have been used to treat thousands of patients throughout the world, and have received much notoriety, including the 2005 Frost & Sullivan "Technology Innovation of the Year Award" for cancer therapy devices.

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 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 and the estimated 2,500 brachytherapy systems installed, as well as with chemotherapy treatments. The MicroThermX 100 system is used to treat cancers that can be destroyed with heat alone.

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Based on our management team's knowledge of the market, we believe that the fully saturated potential market for these developed cancer therapy systems is in excess of $5 billion. We also project an after-market opportunity based on service agreements that equates to approximately 15% of the purchase price of our systems per year. We believe that the replacement cycle for our systems, based on advances in software, hardware and other components, will average 5-7 years. Our financial model in the higher production environment of established commercial sales is to achieve a 60% gross margin on systems and an 80% gross margin on service agreements and disposable applicators used with our MicroThermX 100 system.

We have received United States Food and Drug Administration, or FDA, approval to market our commercial version of the BSD-500, and in March 2006, we completed a submission for FDA approval to sell the BSD-2000 in the United States. We anticipate submitting our MicroThermX 100 system for FDA approval during our fiscal 2007 year. We have designed our cancer therapy systems such that together they are capable of providing treatment for most solid tumors located virtually anywhere in the body.

Although we have not entered these markets, we also believe that our technology has application for additional approaches to treating cancer and for a number of other medical purposes, including the treatment of such conditions as psoriasis, arthritis, fibroids, hemorrhoids, menorrhagra (excessive menstrual bleeding), benign tumors and cysts. We believe our technology is also applicable to treating special medical problems such as sleep apnea and for certain cosmetic uses. Our mission is to develop the full spectrum of medical uses for our special competence in precision-focused RF/microwave systems, and to broadly apply the utilization of our technology to treat cancer and benign diseases and conditions.

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

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 November 30, 2006, we had recorded a reserve for potential inventory impairment of $40,000. We periodically review our inventory levels and usage, paying particular attention to slower-moving items. If projected sales for fiscal 2007 do not materialize or if our hyperthermia systems do not receive increased market acceptance, we may be required to increase the reserve for inventory in future periods.

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 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 allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. As of August 31, 2006 we had a $20,000 balance in this account. During the period ended November 30, 2006, we analyzed our outstanding accounts receivables and determined that we should increase our allowance for doubtful accounts by $83,700 to a balance of $103,700 at November 30, 2006. 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 - On September 1, 2006 we adopted SFAS No. 123(R), which requires us to measure the compensation cost of stock options and other stock-based awards to employees and directors at fair value at the grant date and recognize compensation expense over the requisite service period for awards expected to vest. During the three months ended November 30, 2006, we recorded compensation expense of $204,210 for stock options issued to directors and employees. The fair value of stock options is computed using the Black-Scholes valuation model, which 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. Upon adoption of SFAS No. 123 (R) on September 1, 2006, we closed the balance of deferred compensation of $247,700 to additional paid-in capital.

Results of Operations

Three Months Ended November 30, 2006 Compared to the Three Months Ended November 30, 2005

Revenues. Total revenues for the three months ended November 30, 2006 were $664,655, compared to $521,167, for the three months ended November 30, 2005, an increase of $143,488, or approximately 28%. The increase in total revenues was primarily due to an increase in sales to unrelated parties. Our revenues can 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 our revenue from period to period.

Related Party Sales. We earned $16,044, or approximately 2%, of our revenues in the three months ended November 30, 2006 from sales to related parties as compared to $11,286 or 2%, in the three months ended November 30, 2005. All of the related party revenue in the 2006 period was from sales of component parts to Medizin-Technik.

Non-Related Party Sales. In the three months ended November 30, 2006, we earned $648,611 or 98%, of our revenues from sales to unrelated parties, as compared to $509,881, or 98%, for the three months ended November 30, 2005. These sales for the three months ended November 30, 2006 consisted of product sales of $586,612, consulting services of $31,143, service contracts of $14,110, and probes of $16,746. By comparison, these sales for the three months ended November 30, 2005 consisted of product sales of $445,825, consulting services of $4,645, service contracts of $5,594, probes of $17,923 and other miscellaneous revenue of $35,894.

Gross Profit. Gross profit for the three months ended November 30, 2006 was $215,400 or 32% as compared to $163,667 or 31%, of total product sales for the three months ended November 30, 2005. As sales volumes increases, our employees will be more utilized, thus increasing our gross profit percentage.

Selling General and Administrative Expenses. Selling, general and administrative expenses increased to $1,556,441 in the three months ended November 30, 2006, from $1,054,114 for the three months ended November 30, 2005, an increase of $502,327 or approximately 48%. This increase was primarily due to an increase in sales and marketing costs of $294,083 supporting new product sales and market development activities and $204,210 in compensation expense related to issuance of stock options. We anticipate that our selling, general and administrative expenses will continue at this increased level at least in the short term.

Research and Development Expenses. Research and development expenses were $332,079, for the three months ended November 30, 2006, as compared to $230,165, for the corresponding period of fiscal 2005, an increase of $101,914, or approximately 44%. Research and development expenses in the three months ended November 30, 2006 related to the following:

- Update of our commercial version of the BSD-2000 with complete modernization of the computer system, including addition of the Sigma Ellipse phased array applicator.

- Support for field implementation of a complete new design of the BSD-2000 patient support system, enhancements to the BSD 500 and 2000 systems including language translations of the operating manuals to German and Chinese development of various spiral array applicator systems to compliment the BSD-500.

- Support for PMA filing for the BSD-2000 system, development of the first model of the MicroThermX 100 microwave ablation system.

- Development of new microwave ablation disposable applicators.

- Technical research to evaluate the various treatment sites and diseases suitable for the application of the MicroThermX 100.

Interest income. Interest income increased to $370,213 for the three months ended November 30, 2006 as compared to $244,623 for the three months ended November 30, 2005, due to the significantly higher levels of cash and investments resulting from the sale of our investment in TherMatrx.

Net income (loss). During the three months ended November 30, 2006 we had a net loss of $861,671 after recording a tax benefit of $468,968 as compared to an after tax net income of $3,136,242 in the corresponding period of 2005.

Liquidity and Capital Resources

Since inception through November 30, 2006, we have generated an accumulated deficit of $363,629. We have historically financed our operations through cash from operations, research grants, licensing of technological assets and issuance of common stock. As of November 30, 2006, we had cash, cash equivalents and investments totaling $22,194,147 as compared to cash, cash equivalents and investments totaling $24,735,200 as of August 31, 2006.

During the three months ended November 30, 2006 we used $2,548,110 of cash in operating activities, primarily as a result of our net loss of $861,671, decreases in accrued expenses of $121,131 and income tax payable of $1,500,000, increases in income tax receivable of $367,967, inventories of $107,983 and deferred tax asset of $101,000, offset by increases in accounts payable of $124,860 and decreases in receivables of $16,214 and related party receivables of $34,860. Our investing activities resulted in a decrease in investments of $1,666,755 and the purchase of property and equipment of $23,812.

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 and corporate governance and compliance with the Sarbanes-Oxley Act, during fiscal 2007.

We believe we can cover any cash shortfall with cost cutting or available cash. If we cannot cover any such cash shortfall with cost cutting or available cash, we would need to obtain additional financing. We cannot be certain that any financing will be available when needed or will be available on terms acceptable to us. If we raise equity capital our stockholders will be diluted. Insufficient funds may require us to delay, scale back or eliminate some or all of our programs designed to facilitate the commercial introduction of our systems or entry into new markets.

As of November 30, 2006, we have no significant commitments for the purchase of property and equipment.

The Company has no off balance sheet arrangements as November 30, 2006.

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" 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 the BSD-2000, BSD 500 and MicroThermx 100 systems;
- our expectations to further expand our developments to treat other diseases and medical conditions;

- our expectations that in a higher production environment of established commercial sales we could achieve a 60% gross margin on system sales and an 80% gross margin on service agreements and disposable applicators used with our MicroThermx 100 system;
- our belief concerning the market potential for developed cancer therapy systems;
- our expectations related to the after-market opportunity for service agreements;
- our expectations related to the replacement cycle for our systems;
- our expectations that we will incur increased expenses related to seeking governmental and regulatory approvals for our products;
- our expectations and efforts regarding FDA approvals relating to the BSD-2000 and MicroThermx systems;
- our development or acquisition of new technologies;
- our belief that our technology has application for additional approaches to treating cancer and for other medical purposes;
- the amount of expenses we will incur for the commercial introduction of the BSD-2000 and MicroThermx systems; and
- our belief that our current working capital, investments and cash from operations will be sufficient to finance our operations through working capital and capital resources needs for fiscal 2007; and

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, 2006 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 Disclosure About Market Risk.

As of November 30, 2006, our investments consist primarily of highly-liquid mutual funds, which are considered available-for-sale securities. These investments are not held for speculative or trading purposes. Our investments may be exposed to market risk from changes in interest rates and other security market conditions that could impact our results of operations and financial position. Changes in interest rates or other market factors may materially affect the investment income we earn on cash, cash equivalents and investments.

We do not have material foreign operations and are not currently exposed to material risks from changes in foreign currency.

Item 4. 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 for the reasons described below, 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.

In connection with the completion of its review of our financial statements for the fiscal quarter ended November 30, 2006, Tanner LC identified deficiencies that existed in the design or operation of our internal control over financial reporting. These deficiencies included a lack of segregation of duties in our accounting department and a lack of controls over reporting and accounting for deferred income taxes, deferred compensation and stock options. 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 over financial reporting.

During the fiscal quarter covered by this report, with the exception of the matters described above, 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 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in our Annual Report on Form 10-KSB for the year ended August 31, 2006, which could materially affect our business, financial condition or future results of operations. The risks discussed in our Annual Report on Form 10-KSB are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or results of operations.

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: January 16, 2007 /s/ Hyrum A. Mead

President (Principal Executive Officer)

Date: January 16, 2007 /s/ Dennis E. Bradley

Controller (Principal Accounting Officer)