BSD MEDICAL CORP
Form 10-Q
July 14, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended May 31, 2011

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

For the transition period from _____ to _____

Commission File No. 001-32526

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

Delaware	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, including zip code)

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

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	Smaller reporting company ý

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

As of July 13, 2011, there were 29,686,154 shares of the Registrant's common stock, $0.001 par value per share, outstanding.

BSD MEDICAL CORPORATION
FORM 10-Q

FOR THE QUARTER ENDED MAY 31, 2011

PART I - Financial Information

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

BSD MEDICAL CORPORATION
Condensed Balance Sheets
(Unaudited)

ASSETS	May 31, 2011	August 31, 2010
Current assets:		
Cash and cash equivalents	$18,573,270	$8,483,565
Accounts receivable, net of allowance for doubtful accounts of $20,000	235,656	307,530
Related party trade accounts receivable	856,212	83,834
Income tax receivable	-	50,000
Inventories, net	2,107,016	2,238,254
Other current assets	140,909	135,050
Total current assets	21,913,063	11,298,233
Property and equipment, net	1,436,398	1,352,731
Patents, net	30,357	51,205
	$23,379,818	$12,702,169
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$296,454	$197,082
Accrued liabilities	295,144	223,920
Customer deposits	25,000	-
Deferred revenue – current portion	58,519	89,591
Total current liabilities	675,117	510,593
Deferred revenue – net of current portion	78,238	73,351
Total liabilities	753,355	583,944
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.001 par value; 10,000,000 shares authorized, no shares issued and outstanding	-	-
Common stock, $.001 par value; 80,000,000 shares authorized, 29,636,154 and 26,178,679 shares issued, respectively	29,636	26,179
Additional paid-in capital	50,046,937	36,223,350
Treasury stock, 24,331 shares at cost	(234)	(234)
Accumulated deficit	(27,449,876)	(24,131,070)

Total stockholders' equity	22,626,463	12,118,225
	$23,379,818	$12,702,169

See accompanying notes to condensed financial statements

BSD MEDICAL CORPORATION
Condensed Statements of Operations
(Unaudited)

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2011	2010	2011	2010
Revenues:				
Sales	$ 647,732	$ 64,231	$ 1,506,904	$ 923,574
Sales to related parties	1,017,845	59,371	1,058,597	226,305
Equipment rental	9,900	-	61,400	-
Total revenues	1,675,477	123,602	2,626,901	1,149,879
Cost of Revenues:				
Cost of sales	90,064	260,539	808,732	1,004,138
Cost of related party sales	547,766	86,402	585,261	248,780
Cost of equipment rental	3,608	-	13,111	-
Total cost of revenues	641,438	346,941	1,407,104	1,252,918
Gross margin (loss)	1,034,039	(223,339)	1,219,797	(103,039)
Operating costs and expenses:				
Research and development	481,994	795,294	992,110	1,959,922
Selling, general and administrative	1,389,175	1,371,673	3,589,573	4,207,412
Total operating costs and expenses	1,871,169	2,166,967	4,581,683	6,167,334
Loss from operations	(837,130)	(2,390,306)	(3,361,886)	(6,270,373)
Other income (expense):				
Interest income	21,708	3,073	47,331	7,373
Other income (expense)	(1,318)	(344)	(3,451)	2,134
Total other income (expense)	20,390	2,729	43,880	9,507
Loss before income taxes	(816,740)	(2,387,577)	(3,318,006)	(6,260,866)
Income tax benefit (provision)	(800)	-	(800)	6,571
Net loss	$ (817,540)	$ (2,387,577)	$ (3,318,806)	$ (6,254,295)
Net loss per common share:				
Basic	$ (0.03)	$ (0.10)	$ (0.12)	$ (0.28)
Diluted	$ (0.03)	$ (0.10)	$ (0.12)	$ (0.28)
Weighted average number of shares outstanding:				

Basic	29,612,000	23,682,000	28,553,000	22,644,000
Diluted	29,612,000	23,682,000	28,553,000	22,644,000

See accompanying notes to condensed financial statements

BSD MEDICAL CORPORATION
Condensed Statements of Cash Flows
(Unaudited)

	Nine Months Ended May 31,	
	2011	2010
Cash flows from operating activities:		
Net loss	$(3,318,806)	$(6,254,295)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	111,216	107,552
Stock-based compensation	728,697	763,475
Stock issued for services	150,164	150,000
Decrease (increase) in:		
Receivables	(700,504)	209,421
Income tax receivable	50,000	1,365,758
Inventories	131,238	(356,183)
Other current assets	(5,859)	(81,168)
Increase (decrease) in:		
Accounts payable	99,372	192,766
Accrued liabilities	71,224	(310,706)
Customer deposits	25,000	-
Deferred revenue	(26,185)	25,576
Net cash used in operating activities	(2,684,443)	(4,187,804)
Cash flows from investing activities:		
Purchase of property and equipment	(174,035)	(111,432)
Cash flows from financing activities:		
Net proceeds from the sale of common stock	9,702,656	3,987,549
Proceeds from the exercise of warrants	2,989,407	-
Proceeds from the exercise of stock options	256,120	-
Net cash provided by financing activities	12,948,183	3,987,549
Net increase (decrease) in cash and cash equivalents	10,089,705	(311,687)
Cash and cash equivalents, beginning of period	8,483,565	7,791,938
Cash and cash equivalents, end of period	$18,573,270	$7,480,251

See accompanying notes to condensed financial statements

BSD MEDICAL CORPORATION
Notes to Condensed Financial Statements
(Unaudited)

Note 1. Basis of Presentation

The interim financial information of BSD Medical Corporation (the "Company") as of May 31, 2011 and for the three months and nine months ended May 31, 2011 and 2010 is unaudited, and the condensed balance sheet as of August 31, 2010 is derived from our audited financial statements. The accompanying unaudited condensed balance sheets as of May 31, 2011 and August 31, 2010, the related unaudited condensed statements of operations for the three months and nine months ended May 31, 2011 and 2010, and the related unaudited condensed statements of cash flows for the nine months ended May 31, 2011 and 2010 have been prepared in accordance with U.S. generally accepted accounting principles for interim financial reporting and pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). The condensed financial statements do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. These condensed financial statements should be read in conjunction with the notes thereto, and the financial statements and notes thereto included in our annual report on Form 10-K for the year ended August 31, 2010.

All adjustments (consisting only of normal recurring adjustments) necessary for the fair presentation of our financial position as of May 31, 2011 and August 31, 2010, our results of operations for the three months and nine months ended May 31, 2011 and 2010, and our cash flows for the nine months ended May 31, 2011 and 2010 have been included. The results of operations for the three months and nine months ended May 31, 2011 may not be indicative of the results for our fiscal year ending August 31, 2011.

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

Note 2. Inventories

Inventories consisted of the following:

	May 31, 2011	August 31, 2010
Parts and supplies	$1,209,345	$1,164,697
Work-in-process	891,138	1,130,320
Finished goods	106,533	43,237
Reserve for obsolete inventory	(100,000)	(100,000)
Inventories, net	$2,107,016	$2,238,254

Note 3. Property and Equipment

Property and equipment consisted of the following:

	May 31, 2011	August 31, 2010
Equipment	$1,274,295	$1,181,985
Rental equipment	58,940	-
Furniture and fixtures	298,576	298,576
Building improvements	47,005	24,220
Building	956,000	956,000
Land	244,000	244,000
	2,878,816	2,704,781
Less accumulated depreciation	(1,442,418)	(1,352,050)
Property and equipment, net	$1,436,398	$1,352,731

Note 4. Stockholders' Equity

The Company has 10,000,000 authorized shares of $.001 par value preferred stock. As of May 31, 2011 and August 31, 2010, there were no shares of preferred stock outstanding.

In February 2011, the stockholders of the Company approved an amendment to the Company's Amended and Restated Certificate of Incorporation to increase the number of shares of authorized $.001 par value common stock from 40,000,000 to 80,000,000.

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

November 2010 Stock Offering

On November 15, 2010, we entered into a placement agency agreement (the "November Agency Agreement") with Roth Capital Partners, LLC (the "Placement Agent"), pursuant to which the Placement Agent agreed to use its reasonable efforts to arrange for the sale of up to 1,750,000 shares of our common stock and warrants to purchase up to 875,000 shares of our common stock in a registered direct public offering (the "November Offering"). The Placement Agent was entitled to a cash fee of 6.5% of the gross proceeds paid to us for the securities we would sell in the November Offering. We would also reimburse the Placement Agent for all reasonable and documented out-of-pocket expenses that have been incurred by the Placement Agent in connection with the November Offering, which could not exceed the lesser of (i) $30,000 or (ii) 8% of the gross proceeds of the November Offering, less the Placement Agent's placement fee.

The November Agency Agreement contains customary representations, warranties and covenants by us. It also provides for customary indemnification by us and the Placement Agent for losses or damages arising out of or in connection with the sale of the securities being offered. We agreed to indemnify the Placement Agent against liabilities under the Securities Act of 1933, as amended. We also agreed to contribute to payments the Placement Agent may be required to make in respect of such liabilities.

Also on November 15, 2010, we and certain institutional investors entered into a securities purchase agreement (the "November Purchase Agreement") in connection with the November Offering, pursuant to which we agreed to sell an aggregate of 1,750,000 shares of our common stock and warrants to purchase a total of 875,000 shares of our common stock to such investors for aggregate gross proceeds, before deducting fees to the Placement Agent and other estimated offering expenses payable by us, of approximately $10.45 million. The common stock and warrants were sold in fixed combinations, with each combination consisting of one share of common stock and a warrant to purchase 0.50 shares of common stock. The purchase price was $5.97 per fixed combination. The warrants will become exercisable six months and one day following the closing date of the November Offering and will remain exercisable for five years thereafter at an exercise price of $7.73 per share. The exercise price of the warrants is subject to adjustment in the case of stock splits, stock dividends, combinations of shares and similar recapitalization transactions.

The exercisability of the warrants may be limited if, upon exercise, the holder or any of its affiliates would beneficially own more than 4.9% of our common stock.

We agreed with each of the purchasers that while the warrants are outstanding, we will not affect or enter into an agreement to affect a "Variable Rate Transaction," which means a transaction in which we:

- issue or sell any convertible securities either (A) at a conversion, exercise or exchange rate or other price that is based upon and/or varies with the trading prices of, or quotations for, the shares of our common stock at any time after the initial issuance of such convertible securities, or (B) with a conversion, exercise or exchange price that is subject to being reset at some future date after the initial issuance of such convertible securities or upon the occurrence of specified or contingent events directly or indirectly related to our business or the market for our common stock, other than pursuant to a customary "weighted average" anti-dilution provision; or

- enter into any agreement (including, without limitation, an equity line of credit) whereby we may sell securities at a future determined price (other than standard and customary "preemptive" or "participation" rights).

We agreed with each of the purchasers that if we issue securities within the 12 months following the closing of the November Offering, the purchasers shall have the right to purchase all of the securities on the same terms, conditions and price provided for in the proposed issuance of securities.

We agreed to indemnify each of the purchasers against certain losses resulting from our breach of any of our representations, warranties, or covenants under agreements with each of the purchasers, as well as under certain other circumstances described in the November Purchase Agreement.

We closed the November Offering on November 18, 2010. The net proceeds to us from the November Offering, after deducting placement agent fees and the offering expenses borne by us, were approximately $9.7 million.

The November Offering was completed using our shelf registration statement on Form S-3, pursuant to a prospectus supplement filed with the SEC.

Warrants

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

A summary of the warrants as of May 31, 2011, and changes during the nine months then ended, is as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contract Term (Years)
Outstanding at August 31, 2010	3,034,657	$ 2.37	
Issued	875,000	7.73	
Exercised	(1,501,134)	1.99	
Forfeited or expired	-	-	
Outstanding and exercisable at May 31, 2011	2,408,523	4.56	4.74

Note 5. Net Loss Per Common Share

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

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

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2011	2010	2011	2010
Weighted average number of shares outstanding – basic	29,612,000	23,682,000	28,553,000	22,664,000
Dilutive effect of stock options	-	-	-	-

and warrants				
Weighted average number of shares outstanding – diluted	29,612,000	23,682,000	28,553,000	22,664,000

No stock options or warrants are included in the computation of diluted weighted average number of shares for the three months and nine months ended May 31, 2011 and 2010 because the effect would be anti-dilutive. As of May 31, 2011, we had outstanding options and warrants to purchase a total of 5,286,762 shares of our common stock that could have a future dilutive effect on the calculation of earnings per share.

Note 6. Related Party Transactions

During the three months ended May 31, 2011 and 2010, we had sales of $1,017,845 and $59,371, respectively, to entities controlled by a significant stockholder and member of the Board of Directors. These related party transactions represent approximately 61% and 48% of total sales for each respective three-month period.

During the nine months ended May 31, 2011 and 2010, we had sales of $1,058,597 and $226,305, respectively, to these related parties, representing approximately 40% and 20% of total sales for each respective nine-month period.

As of May 31, 2011 and August 31, 2010, receivables included $856,212 and $83,834, respectively, from these related parties.

Note 7. Stock-Based Compensation

We have both an employee and director stock incentive plan, which are described more fully in Note 11 in our 2010 Annual Report on Form 10-K. As of May 31, 2011, we had approximately 3,034,000 shares of common stock reserved for future issuance under the stock incentive plans.

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

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2011	2010	2011	2010
Cost of sales	$ 16,442	$ (4,488)	$ 21,062	$ 28,242
Research and development	64,571	29,827	120,834	125,701
Selling, general and administrative	251,358	138,822	586,801	609,532
Total	$ 332,371	$ 164,161	$ 728,697	$ 763,475

During the nine months ended May 31, 2011, we granted employees 882,000 stock options with exercise prices ranging from $3.53 to $4.81 per share and with one third vesting each year for the next three years. The estimated weighted average grant date fair value per share of these stock options was $2.21, and our weighted average assumptions used in the Black-Scholes valuation model to determine this estimated fair value are as follows:

Expected volatility	64.75%
Expected dividends	0%
Expected term	5.6 years
Risk-free interest rate	2.09%

Unrecognized stock-based compensation expense expected to be recognized over the estimated weighted-average amortization period of 1.81 years is approximately $2,975,000 as of May 31, 2011.

A summary of the time-based stock option awards as of May 31, 2011, and changes during the nine months then ended, is as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contract Term (Years)	Aggregate Intrinsic Value
Outstanding at August 31, 2010	2,201,386	$ 3.19		
Granted	882,000	4.62		
Exercised	(171,547)	1.55		
Forfeited or expired	(33,600)	4.90		
Outstanding at May 31, 2011	2,878,239	3.71	7.06	
Exercisable at May 31, 2011	1,173,467	$ 3.52	5.78	$1,239,191

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value, based on our closing stock price of $3.64 as of May 31, 2011, which would have been received by the holders of in-the-money options had the option holders exercised their options as of that date.

Note 8. Research and Development Expenses

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

We have recorded the $488,958 proceeds from the QTDP grants as an offset to research and development expenses in the nine months ended May 31, 2011.

Note 9. Supplemental Cash Flow Information

We paid no amounts for interest expense during the nine months ended May 31, 2011 and 2010. We paid $800 and $0 for income taxes during the nine months ended May 31, 2011 and 2010, respectively.

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

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

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During the nine months ended May 31, 2010, we had no non-cash financing and investing activities.

Note 10. Recent Accounting Pronouncements

There were no new accounting pronouncements issued during the nine months ended May 31, 2011 and through the date of this report that we believe are applicable to or would have a material impact on the financial statements of the Company.

Note 11. Subsequent Events

In June 2011, we issued 50,000 shares of our common stock to a director upon his exercise of stock options.

In July 2011, the Board of Directors of the Company approved the grant of stock options to two employees of the Company for a total of 24,000 shares, vesting over three years and exercisable at $3.85 per share.

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

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

Overview

We develop, manufacture, market, and service systems to treat cancer and benign diseases using heat therapy delivered using focused microwave and radiofrequency ("RF") energy. Our product lines include both hyperthermia and ablation treatment systems.

Backlog

As of July 13, 2011, the Company had a sales backlog of $270,000, consisting of hyperthermia systems. The timing of reporting the sales for these systems will depend on the delivery of the systems to the customers, collection of the sales price and other revenue recognition criteria. In some instances, this process could require a number of months.

MicroThermX® Microwave Ablation System

Our MicroThermX® Microwave Ablation System ("MicroThermX®") is a compact, mobile, state-of-the-art, proprietary system that includes a microwave generator, single-patient-use disposable antennas, and a thermistor-based temperature monitoring system. The innovative design of the MicroThermX® is the first of its kind that allows delivery of higher power levels using a single generator. The MicroThermX® utilizes proprietary synchronous phased array technology that was developed and patented by us to provide larger and more uniform zones of ablation during a single procedure. The MicroThermX® introduces into our product line a high-end disposable antenna that is used in each ablation treatment, which we believe represents the potential for a significant ongoing revenue stream after the sale of the system.

In August 2010, the U.S. Food and Drug Administration ("FDA") granted us a 510(k) clearance to market the MicroThermX® for ablation of soft tissue. Clearance from the FDA of the 510(k) Premarket Notification submission authorizes the commercial sale of the MicroThermX® in the United States. We have also received CE Marking for the MicroThermX®, which allows us to market the MicroThermX® in the thirty countries that comprise the European Union ("EU") and the European Free Trade Association ("EFTA"). CE Marking is also recognized in many countries outside of the EU, providing us the ability to market the MicroThermX® to a number of international markets.

After increasing production capacity, completing placement of systems in key hospitals, and witnessing early clinical successes, we have signed geographically exclusive distribution agreements for the MicroThermX® product line with four domestic specialty distribution firms. This completes our strategic initiative to capitalize on the large ablation market by establishing an exclusive, specialty distribution network that will provide nationwide sales coverage for the MicroThermX® line of products. Distributors have been selected based on their sales record, their synergistic product mix, and their focus in the field of interventional oncology/radiology, the target market for our ablation product line.

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To support the global distribution network for the MicroThermX® product line, we have increased our marketing and sales staff, including additional Regional Sales Management. We believe that increasing MicroThermX® marketing and sales resources to support our existing management team is key to making the strategic decision to utilize specialty distribution firms a success. We believe additional marketing and sales resources will provide hands-on field training and management of the distribution network. We further believe the sales and distribution network that is now in place will ensure that trained sales representatives are presenting the advantages of the MicroThermX® to interventional oncologists throughout the United States.

The increased sales activity has resulted in a full schedule of clinical evaluations over the coming weeks. These evaluations represent an important milestone in the MicroThermX® sales cycle, with hospital capital budgeting, committee review and other approvals required to complete the sales cycle. The evaluations have led to an increase in the number of sites that may decide to purchase equipment following clinical evaluations.

We have met with over forty international distribution firms and have started contract negotiations with select European based firms. We anticipate visiting the headquarters of these specialty distribution firms in the coming weeks to finalize contract negotiations and begin training of international distributor sales representatives. In January 2011, we announced the sale and shipment of the first MicroThermX® to one of the largest interventional radiology/oncology distributors in Italy, and we anticipate additional international shipments of the MicroThermX® and supplies of disposable antennas later in calendar year 2011.

The medical facilities where we initially placed MicroThermX® systems continue to reorder disposable microwave antennas, providing early validation of the potential ongoing revenue stream we anticipate. In addition, existing users of the MicroThermX® are reporting positive clinical results in the treatment of tumors.

Our Italian distributor continues to report more cases performed with the MicroThermX®, having equally good clinical results. The distributor is co-sponsoring with us clinical trials that are anticipated to start in the next fiscal quarter.

Hyperthermia Systems

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

BSD-500. Our BSD-500 Hyperthermia System, or the BSD-500, is used to deliver either superficial hyperthermia therapy, which is non-invasive and delivered externally using antennae placed over the tumor, or interstitial hyperthermia therapy, which is delivered using antennae that are inserted into the tumor, or both. These systems consist of four major subsystems: a microwave power generator delivery subsystem; a proprietary, thermistor-based, thermometry subsystem; a computerized monitoring and control subsystem; and an applicator subsystem. These systems include a touch screen display monitor by which the operator controls the hyperthermia treatment, computer equipment and software that controls the delivery of microwave energy to the tumor, and a generator that creates the needed microwave energy for the treatment. Additionally, the systems include a variety of applicator (radiating antennae) configurations, depending on the system. Various configurations of non-invasive applicators (antennae) are used for superficial hyperthermia treatments. For interstitial hyperthermia treatments, the system may include up to 24 small microwave heat-delivering antennae that are inserted into catheters used for internal radiation therapy (called brachytherapy).

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

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

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

The BSD-2000 has not yet received approval from the FDA for commercial marketing in the United States, but the BSD-2000 has obtained an investigational device exemption, or IDE, for placement in the United States for research purposes only. We have also certified the BSD-2000 family for the CE Mark required for export into certain European and non-European countries and have obtained regulatory approval for the sale of the BSD-2000 in the People's Republic of China.

In March 2006, we filed an FDA submission requesting PMA for the BSD-2000. During the PMA review process, we worked closely with the FDA to determine an appropriate pathway to obtain a marketing approval for the BSD-2000 utilizing the clinical data that was available to us to support marketing approval. During this process, the FDA suggested that the Humanitarian Device Exemption ("HDE") marketing approval process might be the most expeditious pathway for us to obtain marketing approval.

On May 18, 2009, the FDA granted Humanitarian Use Device ("HUD") designation for our BSD-2000 for use in conjunction with radiation therapy for the treatment of cervical carcinoma patients who are ineligible for chemotherapy. This is the first of the two steps required to obtain HDE marketing approval. Subsequent to the FDA granting the HUD for the BSD-2000, which confirms that the intended use population is fewer than 4,000 patients per year, we filed an HDE submission with the FDA. As of the date of filing this report, the FDA continues its review of our HDE marketing submission for the BSD-2000. We are unable to predict when the review process will be completed and its ultimate outcome. If we are unable to receive HDE marketing approval, or if the FDA requires us to undergo extensive testing in order to grant HDE marketing approval, our business might be adversely affected.

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The PMA was placed on hold until the HUD designation was granted by the FDA. Once the HUD designation was granted and the HDE was filed, per FDA regulations, we withdrew the PMA submission. We can decide to pursue PMA for the BSD-2000 at a future date.

The HDE approval of the BSD-2000 will authorize the commercial sale of the BSD-2000 in the United States. However, there are some differences between the HDE marketing approval and PMA approval, as well as some limitations on the HDE approved devices. The HDE approval demonstrates safety and probable benefit, is intended for use in the treatment of a disease that affects fewer than 4,000 individuals in the United States per year, is only granted when no comparable device has been approved to treat the same disease population, and requires approval from an Institutional Review Board before being used in a facility. In addition, we cannot charge an amount for an HDE approved device that exceeds the costs of research and development, fabrication, and distribution. A device can have both PMA and an HDE approval as long as the approvals are for different indications for use. In addition, a product can have multiple HDE approvals for different applications, and we may decide to pursue additional HDE approvals for the BSD-2000 in the future.

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

We have not yet submitted to the FDA a marketing application for the BSD-2000/3D. However, we have obtained the CE Mark necessary to export the BSD-2000/3D to certain European countries and other countries requiring CE Mark certification.

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

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

As is the case for the BSD-2000/3D, we have not yet submitted to the FDA a marketing application for the BSD-2000/3D/MR. We can, however, market the BSD-2000/3D/MR in Europe as we have CE Mark approval for the BSD-2000/3D/MR, provided we interface the system with an MRI system that also is approved in Europe.

Results of Operations

Fluctuation in Operating Results

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

With the decrease in our revenues in our fiscal year ended August 31, 2010 compared to the prior fiscal year, primarily as a result of the decrease in sales of our hyperthermia systems, we implemented expense reduction measures to reduce the level of our monthly operating cash burn, including an employee reduction and reduction in the level of involvement of certain key outside consultants. With this reduction in force, we closed a satellite office in Arizona and also reduced other operating expenses such as payroll taxes, employee benefits and travel.

To continue the roll out of the MicroThermX® product line and to support its global distribution network, we have increased our marketing and sales staff and incurred additional marketing, sales and related operating expenses. We believe, therefore, that the level of our operating expenses may increase over the level reported for the three months and nine months ended May 31, 2011, and the increase may be significant.

Revenues

Through May 31, 2011, most of our operating revenues have been from the sale of our hyperthermia cancer systems. We recognize revenue from the sale of our hyperthermia cancer treatment systems and related parts and accessories (collectively, “product sales”), the sale of consumable devices used with certain of our systems, training, service support contracts and other miscellaneous revenues. During the three months and nine months ended May 31, 2011, we received equipment rental income from an operating lease for a hyperthermia system. Our revenues can fluctuate significantly from period to period because our sales, to date, have been based upon a relatively small number of hyperthermia systems, the sales price of each being substantial enough to greatly impact revenue levels in the periods in which they occur. Sales of a few hyperthermia systems, particularly BSD-2000/3D/MR systems, can cause a large change in our revenues from period to period and the sales cycle for our systems generally extends over multiple financial reporting periods. In addition, differences in the configuration of the hyperthermia systems sold, pricing, and other factors can result in significant differences in the sales price per system and in the total revenues reported in a given period. As a result, there may be quarterly financial reporting periods where we may report no or minimal revenues from the sale of hyperthermia systems.

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

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

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

In January 2011, we sold our first MicroThermX® to a customer in Italy. We had no other sales of the MicroThermX® through May 31, 2011. The MicroThermX® product line represents a major part of our business plan moving forward, and we believe the growth in our revenues and our ultimate profitability will be largely dependent on the success of our MicroThermX® sales and marketing efforts. In addition, as discussed above, the MicroThermX® introduces into our product line a disposable antenna used in each treatment, which we believe represents the potential for a significant ongoing revenue stream after the sale of the system. However, we cannot be sure that revenues from the MicroThermX® family of products will be consistent with our expectations.

The following table summarizes the number of systems sold for the three months and nine months ended May 31, 2011 and 2010:

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2011	2010	2011	2010
MicroThermX®	-	-	1	-
Hyperthermia Systems:				
BSD-500	1	-	3	2
BSD-2000	1	-	2	2
BSD-2000/3D	-	-	-	-
BSD-2000/3D/MR	1	-	1	-
Total Hyperthermia Systems	3	-	6	4

Our sales to related parties are comprised of the sale of hyperthermia systems and related component parts and services sold to Medizin-Technik GmbH and Dr. Gerhard Sennewald. Dr. Sennewald, one of our directors and significant stockholders, is a stockholder, executive officer and a director of Medizin-Technik GmbH. At times, these related party sales represent a significant portion of our revenues. We derived $1,017,845, or approximately 61%, of our total revenues in the three months ended May 31, 2011 from sales to related parties, compared to $59,371, or approximately 48%, in the three months ended May 31, 2010. We derived $1,058,597, or approximately 40%, of our total revenues in the nine months ended May 31, 2011 from sales to related parties, compared to $226,305, or approximately 20%, in the nine months ended May 31, 2010. We had no sales of hyperthermia systems to related parties in the three months or nine months ended May 31, 2010.

The following tables summarize the sources of our sales for the three months and nine months ended May 31, 2011 and 2010:

	Three Months Ended May 31,		Nine Months Ended May 31,	
Non-Related Parties	2011	2010	2011	2010
Product sales	$ 550,000	$ -	$ 1,316,350	$ 795,440
Consumable devices	50,544	6,900	51,144	11,100
Service contracts	37,292	42,543	110,672	95,349
Other	9,896	14,788	28,738	21,685
Total	$ 647,732	$ 64,231	$ 1,506,904	$ 923,574
Related Parties				
Product sales	$ 1,010,687	$ 55,875	$ 1,011,587	$ 166,050
Consumable devices	900	-	28,650	16,500
Other	6,258	3,496	18,360	43,755
Total	$ 1,017,845	$ 59,371	$ 1,058,597	$ 226,305

During the three months and nine months ended May 31, 2011, we had $9,900 and $61,400 of equipment rental revenues from an operating lease of a BSD-500 to one customer. We had no such equipment rental revenues in the three months and nine months ended May 31, 2010.

Total revenues for the three months ended May 31, 2011 were $1,675,477 compared to $123,602 for the three months ended May 31, 2010, an increase of $1,551,875. Total revenues for the nine months ended May 31, 2011 were $2,626,901 compared to $1,149,879 for the nine months ended May 31, 2010, an increase of $1,477,022. On a year-to-date basis, total revenues increased approximately 128% over total revenues for the same nine-month period in the prior fiscal year. The increase in revenues in the three months and nine months ended May 31, 2011 is due primarily to the sale of more hyperthermia systems, including a BSD-2000 3D/MR, and the addition of equipment rental revenues.

Cost of Revenues

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

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

Total cost of revenues for the three months ended May 31, 2011 was $641,438 compared to $346,941 for the three months ended May 31, 2010, an increase of $294,497, or approximately 85%. Total cost of revenues for the nine months ended May 31, 2011 was $1,407,104 compared to $1,252,918 for the nine months ended May 31, 2010, an increase of $154,186, or approximately 12%. This increase resulted primarily from increased sales of hyperthermia systems and the addition of cost of equipment rental in the current fiscal year.

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Gross Margin

Our gross margin and gross margin percentage will fluctuate from period to period depending on revenue levels and the mix of revenues reported for the period and the type and configuration of the hyperthermia systems sold during the period. Our total gross margin was $1,034,039, or approximately 62% of total revenues, for the three months ended May 31, 2011 and $1,219,797, or approximately 46% of total revenues for the nine months ended May 31, 2011. By comparison, our total gross margin was $(223,339) and $(103,039) for the three months and nine months ended May 31, 2010, respectively. The increase in gross margin and gross margin percentage in the current fiscal year resulted primarily from increased sales of hyperthermia systems and the gross margin contributed by our equipment rental.

Operating Costs and Expenses

Research and Development Expenses – Research and development expenses include expenditures for new product development and development of enhancements to existing products. Our research and development expenses for the nine months ended May 31, 2011 have been offset by the $488,958 proceeds from two separate U.S. government grants under the QTDP Program received in our first fiscal quarter ended November 30, 2010. Research and development expenses were $481,994 for the three months ended May 31, 2011 compared to $795,294 for the three months ended May 31, 2010, a decrease of $313,300, or approximately 39%. Research and development expenses were $992,110 for the nine months ended May 31, 2011 compared to $1,959,922 for the nine months ended May 31, 2010, a decrease of $967,812, or approximately 49%. In addition to the offset of the QTDP grants in the first quarter ended November 30, 2011, research and development expenses decreased in the current fiscal year primarily from the shift from product development activities to sales and marketing efforts for the MicroThermX® product line, and due to our operating expense reduction measures.

Selling, General and Administrative Expenses – Selling, general and administrative expenses were $1,389,175 for the three months ended May 31, 2011 compared to $1,371,673 for the three months ended May 31, 2010, an increase of $17,502, or approximately 1%. Selling, general and administrative expenses were $3,589,573 for the nine months ended May 31, 2011 compared to $4,207,412 for the nine months ended May 31, 2010, a decrease of $617,839, or approximately 15%. The decrease in selling, general and administrative expenses on a year-to-date basis in the current fiscal year is due to the headcount reductions and other operating expense reduction measures implemented in the latter part of last fiscal year. As discussed above, however, as we continue the roll out of the MicroThermX® product line and the support of its global distribution network, we have increased our marketing and sales staff, including three regional sales managers, a director of marketing and a customer service manager, and incurred additional marketing, sales and related operating expenses. As a result, we incurred an increase in our selling, general and administrative expenses for the three months ended May 31, 2011. We believe that the level of our selling, general and administrative expenses will continue to increase over the levels reported for the three months and nine months ended May 31, 2011, and the increase may be significant.

Other Income (Expense)

During the three months and nine months ended May 31, 2011 and 2010, our other income (expense) was not material to our operations.

Liquidity and Capital Resources

Since inception through May 31, 2011, we have generated an accumulated deficit of $27,449,876. Generally, our operating revenues have been insufficient to cover our operating expenses. We have financed our operations primarily through the sale of an investment in a spinoff operation and the issuance of our common stock and warrants. As of May 31, 2011, we had cash and cash equivalents of $18,573,270, comprised primarily of money

market funds.

As of May 31, 2011, we had current liabilities totaling $675,117, comprised of accounts payable, accrued liabilities, customer deposits and deferred revenue incurred in the normal course of our business. Our long-term liabilities consisted of deferred revenue of $78,238.

Stock Offerings

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

In February, May and August 2010 we completed three stock offerings with institutional investors utilizing our shelf registration statement whereby we received total proceeds, net of offering costs, of approximately $6.5 million.

November 2010 Stock Offering

On November 15, 2010, we entered into the November Agency Agreement with the Placement Agent, pursuant to which the Placement Agent agreed to use its reasonable efforts to arrange for the sale of up to 1,750,000 shares of our common stock and warrants to purchase up to 875,000 shares of our common stock in a registered direct public offering. The Placement Agent was entitled to a cash fee of 6.5% of the gross proceeds paid to us for the securities we would sell in the November Offering. We would also reimburse the Placement Agent for all reasonable and documented out-of-pocket expenses that have been incurred by the Placement Agent in connection with the November Offering, which could not exceed the lesser of (i) $30,000 or (ii) 8% of the gross proceeds of the November Offering, less the Placement Agent’s placement fee.

The November Agency Agreement contains customary representations, warranties and covenants by us. It also provides for customary indemnification by us and the Placement Agent for losses or damages arising out of or in connection with the sale of the securities being offered. We agreed to indemnify the Placement Agent against liabilities under the Securities Act of 1933, as amended. We also agreed to contribute to payments the Placement Agent may be required to make in respect of such liabilities.

Also on November 15, 2010, we and certain institutional investors entered into the November Purchase Agreement in connection with the November Offering, pursuant to which we agreed to sell an aggregate of 1,750,000 shares of our common stock and warrants to purchase a total of 875,000 shares of our common stock to such investors for aggregate gross proceeds, before deducting fees to the Placement Agent and other estimated offering expenses payable by us, of approximately $10.45 million. The common stock and warrants were sold in fixed combinations, with each combination consisting of one share of common stock and a warrant to purchase 0.50 shares of common stock. The purchase price was $5.97 per fixed combination. The warrants will become exercisable six months and one day following the closing date of the November Offering and will remain exercisable for five years thereafter at an exercise price of $7.73 per share. The exercise price of the warrants is subject to adjustment in the case of stock splits, stock dividends, combinations of shares and similar recapitalization transactions.

The exercisability of the warrants may be limited if, upon exercise, the holder or any of its affiliates would beneficially own more than 4.9% of our common stock.

We agreed with each of the purchasers that while the warrants are outstanding, we will not affect or enter into an agreement to affect a Variable Rate Transaction, which means a transaction in which we:

- issue or sell any convertible securities either (A) at a conversion, exercise or exchange rate or other price that is based upon and/or varies with the trading prices of, or quotations for, the shares of our common stock at any time after the initial issuance of such convertible securities, or (B) with a conversion, exercise or exchange price that is subject to being reset at some future date after the initial issuance of such convertible securities or upon the occurrence of specified or contingent events directly or indirectly related to our business or the market for our common stock, other than pursuant to a customary "weighted average" anti-dilution provision; or

- enter into any agreement (including, without limitation, an equity line of credit) whereby we may sell securities at a future determined price (other than standard and customary "preemptive" or "participation" rights).

We agreed with each of the purchasers that if we issue securities within the 12 months following the closing of the November Offering, the purchasers shall have the right to purchase all of the securities on the same terms, conditions and price provided for in the proposed issuance of securities.

We agreed to indemnify each of the purchasers against certain losses resulting from our breach of any of our representations, warranties, or covenants under agreements with each of the purchasers, as well as under certain other circumstances described in the November Purchase Agreement.

We closed the November Offering on November 18, 2010. The net proceeds to us from the November Offering, after deducting placement agent fees and the offering expenses borne by us, were approximately $9.7 million.

The November Offering was completed using our shelf registration statement on Form S-3, pursuant to a prospectus supplement filed with the SEC.

Warrants

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

Cash Flows from Operating, Investing and Financing Activities

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

During the nine months ended May 31, 2010, we used net cash of $4,187,804 in operating activities, primarily as a result of our net loss of $6,254,295, decreased by non cash expenses of $1,021,027, including depreciation and amortization, stock-based compensation and stock issued for services. Net cash used in operating activities also included increases in inventories of $356,183 and other current assets of $81,168 and a decrease of accrued liabilities

of $310,706, partially offset by decreases in receivables of $209,421 and income tax receivable of $1,365,758 and increases in accounts payable of $192,766 and deferred revenue of $25,576.

Net cash used in investing activities for the nine months ended May 31, 2011 and 2010 was $174,035 and $111,432, respectively, resulting from the purchase of property and equipment.

Net cash provided by financing activities for the nine months ended May 31, 2011 was $12,948,183, comprised of net proceeds from the sale of common stock of $9,702,656, proceeds from the exercise of warrants of $2,989,407 and proceeds from the exercise of stock options of $256,120. Net cash provided by financing activities for the nine months ended May 31, 2010 was $3,987,549, comprised of net proceeds from the sale of common stock.

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

As of May 31, 2011, we had no significant commitments for the purchase of property and equipment.

We had no material off balance sheet arrangements as of May 31, 2011.

Other Cash Receipts

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

Critical Accounting Policies

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

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

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

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

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

Revenue from equipment rental under an operating lease is recognized when billed in accordance with the lease agreement.

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

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

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

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

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

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

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

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

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

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

Recent Accounting Pronouncements

There were no new accounting pronouncements issued during the nine months ended May 31, 2011 and through the date of this report that we believe are applicable to or would have a material impact on the financial statements of the Company.

FORWARD-LOOKING STATEMENTS

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

- our belief about the market opportunities for our products;
- our anticipated financial performance and business plan;
- our expectations regarding the commercialization of, and the potential revenue from, the BSD-2000, BSD 500 and MicroThermX® systems;
- our expectations to further expand our developments to treat other forms of cancer and other diseases and medical conditions;
- our expectations that we will continue to incur expenses related to seeking governmental and regulatory approvals for our products;
- our belief that the MicroThermX® will be a major part of our business plan moving forward and that the growth in our revenues and our ultimate profitability will be largely dependent on the success of our MicroThermX® marketing and sales efforts;

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- our expectations regarding the manufacturing, marketing, distribution, roll out and revenues for the MicroThermX® and the estimated timing thereof;

- our expectations that the disposable antenna to be used in conjunction with the MicroThermX® represents a significant ongoing revenue stream;

    - our belief that the increased number of clinical evaluations will result in sales of the MicroThermX®;

- our expectations that additional international shipments of the MicroThermX® and supplies of disposable antennas will occur later in calendar year 2011;

        - our intentions to continue to devote substantial sums to research and development;

- our belief that the level of our operating expenses, including selling, general and administrative expenses, will increase;

- our belief that our operating results, revenue and operating expenses may fluctuate in the future from year to year as well as from quarter to quarter; and

- our belief that our current cash and cash equivalents will be sufficient to finance our operations for the next twelve months.

We wish to caution readers that the forward-looking statements and our operating results are subject to various risks and uncertainties that could cause our actual results and outcomes to differ materially from those discussed or anticipated, including the factors set forth in Item 1A – "Risk Factors" in our Annual Report on Form 10-K for the year ended August 31, 2010 and our other filings with the Securities and Exchange Commission. We also wish to advise readers not to place any undue reliance on the forward-looking statements contained in this report, which reflect our beliefs and expectations only as of the date of this report. We assume no obligation to update or revise these forward-looking statements to reflect new events or circumstances or any changes in our beliefs or expectations, other than as required by law.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934 ("Exchange Act") and are not required to provide the information required under this item.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures.

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our management including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Exchange Act). Based on this evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in applicable rules

and forms and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, in a manner that allows timely decisions regarding required disclosure.

Changes in internal controls over financial reporting.

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

PART II – OTHER INFORMATION

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the risk factors reported in our Annual Report on Form 10-K for the year ended August 31, 2010.

Item 6. Exhibits

The following exhibits are filed as part of this report:

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

SIGNATURES

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

BSD MEDICAL CORPORATION

Date: July 14, 2011	/s/ Harold R. Wolcott Harold R. Wolcott President (Principal Executive Officer)
Date: July 14, 2011	/s/ Dennis P. Gauger Dennis P. Gauger Chief Financial Officer (Principal Accounting Officer)