

UROPLASTY INC  
Form 10-Q  
November 02, 2009

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

**Quarterly Report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Quarterly Period Ended September 30, 2009**

**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. 001-32632**

**UROPLASTY, INC.**

(Exact name of registrant as specified in its Charter)

**Minnesota, U.S.A.**  
(State or other jurisdiction of  
incorporation or organization)

**41-1719250**  
(I.R.S. Employer  
Identification No.)

**5420 Feltl Road**  
**Minnetonka, Minnesota, 55343**  
(Address of principal executive offices)

**(952) 426-6140**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S. YES  NO

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

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

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) YES  NO

As of October 31, 2009 the registrant had 14,946,540 shares of common stock outstanding.

**Table of Contents**  
**INDEX**  
**UROPLASTY INC. AND SUBSIDIARIES**

**PART I. FINANCIAL INFORMATION**

Item 1. Financial Statements

Condensed Consolidated Balance Sheets 3

Condensed Consolidated Statements of Operations 5

Condensed Consolidated Statement of Shareholders' Equity and Comprehensive Loss 6

Condensed Consolidated Statements of Cash Flows 7

Notes to the Condensed Consolidated Financial Statements 8

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 15

Item 3. Quantitative and Qualitative Disclosures about Market Risk 19

Item 4. Controls and Procedures 19

**PART II. OTHER INFORMATION**

Item 1. Legal Proceedings 20

Item 1A. Risk Factors 20

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 20

Item 3. Defaults upon Senior Securities 20

Item 4. Submission of Matters to a Vote of Security Holders 20

Item 5. Other Information 20

Item 6. Exhibits 20

**SIGNATURES** 21

Business Loan Agreement and related Promissory Note dated October 30, 2009

Certification by CEO & CFO pursuant to Section 302

Certification by CEO & CFO pursuant to Section 906

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

UROPLASTY, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

|                                     | <b>September 30,<br/>2009<br/>(unaudited)</b> | <b>March 31,<br/>2009</b> |
|-------------------------------------|---|---------------------------|
| Assets                              |   |                           |
| Current assets:                     |   |                           |
| Cash and cash equivalents           | \$ 1,792,867                                  | \$ 3,276,299              |
| Short-term investments              | 4,000,000                                     | 4,500,000                 |
| Accounts receivable, net            | 1,196,518                                     | 1,214,049                 |
| Inventories                         | 486,269                                       | 495,751                   |
| Other                               | 326,278                                       | 279,898                   |
| Total current assets                | 7,801,932                                     | 9,765,997                 |
| Property, plant, and equipment, net | 1,389,493                                     | 1,401,229                 |
| Intangible assets, net              | 2,955,332                                     | 3,378,648                 |
| Prepaid pension asset               | 86,687  | 66,130                    |
| Deferred tax assets                 | 79,367  | 68,793                    |
| Total assets                        | \$ 12,312,811                                 | \$ 14,680,797             |

See accompanying notes to the condensed consolidated financial statements.

Page 3

---

**Table of Contents**

## UROPLASTY, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

|   | <b>September 30,<br/>2009<br/>(unaudited)</b> | <b>March 31,<br/>2009</b> |
|---|---|---------------------------|
| Liabilities and Shareholders' Equity  |   |                           |
| Current liabilities:  |   |                           |
| Current portion - deferred rent   | \$ 35,000                                     | \$ 35,000                 |
| Accounts payable  | 431,016                                       | 604,593                   |
| Income tax payable  |   | 56,785                    |
| Accrued liabilities:  |   |                           |
| Compensation  | 665,441                                       | 983,052                   |
| Other   | 237,277                                       | 248,568                   |
| Total current liabilities   | 1,368,734                                     | 1,927,998                 |
| Deferred rent - less current portion  | 130,114                                       | 147,576                   |
| Accrued pension liability   | 283,008                                       | 296,646                   |
| Total liabilities   | 1,781,856                                     | 2,372,220                 |
| Commitments and Contingencies   |   |                           |
| Shareholders' equity:   |   |                           |
| Common stock \$.01 par value; 40,000,000 shares authorized,<br>14,946,540 shares issued and outstanding at September 30 and<br>March 31, 2009 | 149,465                                       | 149,465                   |
| Additional paid-in capital  | 36,055,081                                    | 35,763,619                |
| Accumulated deficit   | (25,653,784)                                  | (23,413,350)              |
| Accumulated other comprehensive loss  | (19,807)                                      | (191,157)                 |
| Total shareholders' equity  | 10,530,955                                    | 12,308,577                |
| Total liabilities and shareholders' equity  | \$ 12,312,811                                 | \$ 14,680,797             |

See accompanying notes to the condensed consolidated financial statements.

**Table of Contents**

## UROPLASTY, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

|   | Three Months Ended |              | Six Months Ended |              |
|---|--------------------|--------------|------------------|--------------|
|   | September 30,      |              | September 30,    |              |
|   | 2009               | 2008         | 2009             | 2008         |
| Net sales                                   | \$ 2,986,475       | \$ 3,920,516 | \$ 5,812,404     | \$ 8,446,138 |
| Cost of goods sold                          | 535,074            | 549,199      | 1,087,044        | 1,257,166    |
| Gross profit                                | 2,451,401          | 3,371,317    | 4,725,360        | 7,188,972    |
| Operating expenses                          |                    |              |                  |              |
| General and administrative                  | 713,040            | 918,394      | 1,561,591        | 1,957,108    |
| Research and development                    | 435,898            | 327,978      | 963,713          | 733,498      |
| Selling and marketing                       | 1,968,054          | 2,505,598    | 4,025,342        | 5,125,632    |
| Amortization                                | 211,503            | 210,966      | 423,316          | 421,941      |
|   | 3,328,495          | 3,962,936    | 6,973,962        | 8,238,179    |
| Operating loss                              | (877,094)          | (591,619)    | (2,248,602)      | (1,049,207)  |
| Other income (expense)                      |                    |              |                  |              |
| Interest income                             | 24,230             | 63,542       | 55,629           | 138,656      |
| Interest expense                            | (1,788)            | (6,750)      | (9,694)          | (13,585)     |
| Foreign currency exchange gain (loss)       | (7,365)            | 5,038        | (14,697)         | (732)        |
| Other, net                                  | 2,000              | (4,687)      | (183)            | (4,687)      |
|   | 17,077             | 57,143       | 31,055           | 119,652      |
| Loss before income taxes                    | (860,017)          | (534,476)    | (2,217,547)      | (929,555)    |
| Income tax expense                          | 14,642             | 26,487       | 22,887           | 38,057       |
| Net loss                                    | \$ (874,659)       | \$ (560,963) | \$ (2,240,434)   | \$ (967,612) |
| Basic and diluted loss per common share     | \$ (0.06)          | \$ (0.04)    | \$ (0.15)        | \$ (0.06)    |
| Weighted average common shares outstanding: |                    |              |                  |              |
| Basic and diluted                           | 14,946,540         | 14,916,540   | 14,942,179       | 14,916,540   |

See accompanying notes to the condensed consolidated financial statements.

**Table of Contents**

## UROPLASTY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY AND COMPREHENSIVE  
LOSS

Six months ended September 30, 2009

(Unaudited)

|                                  | Common Stock |            | Additional<br>Paid-in | Accumulated     | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Shareholders |
|----------------------------------|--------------|------------|-----------------------|-----------------|---|-----------------------|
|                                  | Shares       | Amount     | Capital               | Deficit         | (loss)  | Equity                |
| Balance at March 31,<br>2009     | 14,946,540   | \$ 149,465 | \$ 35,763,619         | \$ (23,413,350) | \$ (191,157)                                    | \$ 12,308,577         |
| Share-based<br>compensation      |              |            | 291,462               |                 |   | 291,462               |
| Comprehensive loss               |              |            |                       | (2,240,434)     | 171,350   | (2,069,084)           |
| Balance at<br>September 30, 2009 | 14,946,540   | \$ 149,465 | \$ 36,055,081         | \$ (25,653,784) | \$ (19,807)                                     | \$ 10,530,955         |

See accompanying notes to the condensed consolidated financial statements.

Page 6



**Table of Contents**

## UROPLASTY, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

|   | <b>Six Months Ended</b> |              |
|---|-------------------------|--------------|
|   | <b>September 30,</b>    |              |
|   | <b>2009</b>             | <b>2008</b>  |
| Cash flows from operating activities:                                       |                         |              |
| Net loss  | \$ (2,240,434)          | \$ (967,612) |
| Adjustments to reconcile net loss to net cash used in operating activities: |                         |              |
| Depreciation and amortization   | 567,238                 | 566,949      |
| Loss on disposal of equipment   | 186                     | 4,687        |
| Share-based consulting expense  |                         | 36,409       |
| Share-based compensation expense  | 291,462                 | 453,592      |
| Deferred income taxes   | (3,249)                 | (10,164)     |
| Deferred rent   | (17,500)                | (17,500)     |
| Changes in operating assets and liabilities:                                |                         |              |
| Accounts receivable   | 91,206                  | 537,959      |
| Inventories   | 47,499                  | (11,128)     |
| Other current assets and income tax receivable                              | (102,998)               | (108,041)    |
| Accounts payable  | (185,406)               | (145,610)    |
| Accrued liabilities   | (348,381)               | (634,851)    |
| Accrued pension liability, net and income tax payable                       | (58,492)                | (44,772)     |
| Net cash used in operating activities                                       | (1,958,869)             | (340,082)    |
| Cash flows from investing activities:                                       |                         |              |
| Proceeds from sale of short-term investments                                | 2,500,000               | 8,808,304    |
| Purchase of short-term investments  | (2,000,000)             | (7,891,373)  |
| Purchases of property, plant and equipment                                  | (61,334)                | (130,421)    |
| Proceeds from sale of property, plant and equipment                         | 2,000                   |              |
| Net cash provided by investing activities                                   | 440,666                 | 786,510      |
| Cash flows from financing activities:                                       |                         |              |
| Repayment of debt obligations   |                         | (455,913)    |
| Net cash used in financing activities                                       |                         | (455,913)    |
| Effect of exchange rates on cash and cash equivalents                       | 34,771                  | (194,967)    |
| Net decrease in cash and cash equivalents                                   | (1,483,432)             | (204,452)    |
| Cash and cash equivalents at beginning of period                            | 3,276,299               | 3,880,044    |

|  |              |              |
|--|--------------|--------------|
| Cash and cash equivalents at end of period                                 | \$ 1,792,867 | \$ 3,675,592 |
| Supplemental disclosure of cash flow information:                          |              |              |
| Cash paid during the period for interest                                   | \$ 6,145     | \$ 13,612    |
| Cash paid during the period for income taxes                               | 105,877      | 35,474       |
| See accompanying notes to the condensed consolidated financial statements. |              |              |

Page 7

---

**Table of Contents**

UROPLASTY, INC. AND SUBSIDIARIES  
Notes to the Condensed Consolidated Financial Statements  
(Unaudited)

**1. Basis of Presentation**

We have prepared our condensed consolidated financial statements included in this Form 10-Q, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted, pursuant to such rules and regulations, although we believe that our disclosures are adequate to make the information not misleading. The consolidated results of operations for any interim period are not necessarily indicative of results for a full year. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended March 31, 2009.

The condensed consolidated financial statements presented herein as of September 30, 2009 and for the three and six-month periods ended September 30, 2009 and 2008 reflect, in the opinion of management, all material adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the consolidated financial position, results of operations and cash flows for the interim periods.

We have identified certain accounting policies that we consider particularly important for the portrayal of our results of operations and financial position and which may require the application of a higher level of judgment by our management, and as a result are subject to an inherent level of uncertainty. These are characterized as critical accounting policies and address revenue recognition, accounts receivable, inventories, foreign currency translation and transactions, impairment of long-lived assets, share-based compensation, defined benefit pension plans and income taxes, each of which is described in our Annual Report on Form 10-K for the year ended March 31, 2009. Based upon our review, we have determined that these policies remain our most critical accounting policies for the three and six-month periods ended September 30, 2009, and we have made no changes to these policies during fiscal 2010.

**2. Short-term Investments**

Short-term investments consist of certificates of deposit held-to-maturity that mature within the next twelve months. Based on the short-term nature of these investments, their cost approximates their fair market value. We have determined that short-term investments and cash and cash equivalents are Level 1 inputs within the fair value hierarchy of Accounting Standards Codification (ASC 820), Fair Value Measurements and Disclosures.

**3. Accounts Receivable**

We grant credit to our customers in the normal course of business and, generally, do not require collateral or any other security to support amounts due. If necessary, we have an outside party assist us with performing credit and reference checks and establishing credit limits for the customer. Accounts outstanding longer than the contractual payment terms, are considered past due. We carry our accounts receivable at the original invoice amount less an estimate made for doubtful receivables based on a periodic review of all outstanding amounts. We determine the allowance for doubtful accounts by considering a number of factors, including the length of time accounts receivables are past due, customer financial condition and ability to pay the obligation, historical and expected credit loss experience, and the condition of the general economy and the industry as a whole. We write off accounts receivable when deemed uncollectible. We record recoveries of accounts receivable previously written off when received. We are not always able to timely anticipate changes in the financial condition of our customers and if circumstances related to these customers deteriorate, our estimates of the recoverability of accounts receivable could be materially affected and we may be required to record additional allowances. Alternatively, if more allowances are provided than are ultimately required, we may reverse a portion of such provisions in future periods based on the actual collection experience. Historically, the accounts receivable balances we have written off have generally been within our expectations. The allowance for doubtful accounts was \$114,000 at September 30, 2009 and March 31, 2009.

**Table of Contents****4. Inventories**

Inventories are stated at the lower of cost (first-in, first-out method) or market (net realizable value). Inventories consist of the following:

|                 | <b>September 30,<br/>2009</b> | <b>March 31,<br/>2009</b> |
|-----------------|-------------------------------|---------------------------|
| Raw materials   | \$ 188,865                    | \$ 227,054                |
| Work-in-process | 40,249                        | 23,326                    |
| Finished goods  | 257,155                       | 245,371                   |
|                 | <b>\$ 486,269</b>             | <b>\$ 495,751</b>         |

**5. Intangible Assets**

**Intangible Assets.** Our intangible assets are comprised of patents and licensed technology which we amortize on a straight-line basis over their estimated useful lives or contractual terms, whichever is less.

|                        | <b>Estimated<br/>Lives<br/>(Years)</b> | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization<br/>September 30, 2009</b> | <b>Net value</b> |
|------------------------|--|--------------------------------------|--|------------------|
| Patents and inventions | 6                                      | \$ 5,472,512                         | \$ 2,517,180   | \$ 2,955,332     |

**March 31, 2009**

|                        |   |              |              |              |
|------------------------|---|--------------|--------------|--------------|
| Patents and inventions | 6 | \$ 5,472,512 | \$ 2,093,864 | \$ 3,378,648 |
|------------------------|---|--------------|--------------|--------------|

Estimated annual amortization for these assets for the years ending March 31, is as follows:

|                   |                     |
|-------------------|---------------------|
| Remainder of 2010 | \$ 422,000          |
| 2011              | 843,000             |
| 2012              | 842,000             |
| 2013              | 842,000             |
| 2014              | 4,000               |
| 2015 and beyond   | 2,000               |
|                   | <b>\$ 2,955,000</b> |

**6. Deferred Rent and Leasehold Improvements**

We entered into an 8-year operating lease agreement, effective May 2006, for our corporate facility in Minnesota. As part of the agreement, the landlord provided an incentive of \$280,000 for leasehold improvements. We recorded this incentive as deferred rent and are amortizing it as a reduction in lease expense over the lease term in accordance to ASC 840, Leases. We are amortizing the leasehold improvements over the shorter of the asset life or the lease term.

**Table of Contents****7. Comprehensive Loss**

Comprehensive loss consists of net loss plus accumulated translation adjustment, and pension related items as follows:

|   | <b>Three Months Ended</b> |              | <b>Six Months Ended</b> |                |
|---|---------------------------|--------------|-------------------------|----------------|
|   | <b>September 30,</b>      |              | <b>September 30,</b>    |                |
|   | <b>2009</b>               | <b>2008</b>  | <b>2009</b>             | <b>2008</b>    |
| Net loss                                    | \$ (874,659)              | \$ (560,963) | \$ (2,240,434)          | \$ (967,612)   |
| Items of other comprehensive income (loss): |                           |              |                         |                |
| Accumulated translation adjustment          | 60,116                    | (326,738)    | 176,067                 | (317,868)      |
| Pension related                             | (4,146)                   | 11,774       | (4,717)                 | 11,795         |
| <br>  |                           |              |                         |                |
| Comprehensive loss                          | \$ (818,689)              | \$ (875,927) | \$ (2,069,084)          | \$ (1,273,685) |

Other accumulated comprehensive income (loss) at September 30, 2009 totalled \$(19,807) and consists of \$33,678 for accumulated translation adjustment and \$(53,485) for accumulated additional pension liability.

**8. Net Loss per Common Share**

The following restricted stock, options and warrants outstanding at September 30, 2009 and 2008, to purchase shares of common stock, were excluded from diluted loss per common share because of their anti-dilutive effect:

|                           | <b>Number of<br/>Restricted<br/>Stock/Options/Warrants</b> | <b>Range of<br/>Exercise Prices</b> |
|---------------------------|--|-------------------------------------|
| For the six months ended: |  |                                     |
| September 30, 2009        | 4,555,928  | \$0.69 to \$5.30                    |
| September 30, 2008        | 4,340,361  | \$1.82 to \$5.30                    |

**9. Credit Facilities**

Uroplasty BV, our subsidiary, has an agreement with Rabobank of The Netherlands for a 500,000 (approximately \$730,000) credit line. The bank charges interest on the loan at the rate of one percentage point over the Rabobank base interest rate (4.85% base rate on September 30, 2009), subject to a minimum interest rate of 3.5% per annum. At September 30, 2009, we had no borrowings outstanding on this credit line.

**10. Warrants**

As of September 30, 2009, we had issued and outstanding warrants to purchase an aggregate of 2,066,928 common shares, at a weighted average exercise price of \$3.78.

In connection with the equity offerings of April 2005 private placement, August 2006 private placement and December 2006 follow-on offering, we issued five-year warrants to purchase 1,180,928, 764,500, 121,500 common shares, respectively, at exercise prices of \$4.75, \$2.50 and \$2.40 per share, respectively.

**11. Share-based Compensation**

As of September 30, 2009, we had one active plan (2006 Amended Stock and Incentive Plan) for share-based compensation grants. Under the plan, if we have a change in control, all outstanding grants, including those subject to vesting or other performance targets, fully vest immediately. Under this plan, we had reserved 2,700,000 shares of our common stock for share-based grants. As of September 30, 2009, we had remaining 1,497,500 shares available for grant. We grant option awards with an exercise price equal to the closing market price of our stock at the date of the grant.

**Table of Contents**

We account for share-based compensation costs under ASC 718, Compensation Stock Compensation. We incurred a total of approximately \$291,000 and \$490,000 in share-based expense (inclusive of \$0 and \$36,000, respectively, for option grants to consultants) for the six months ended September 30, 2009 and 2008, respectively.

We determined the fair value of our option awards using the Black-Scholes option pricing model. We used the following weighted-average assumptions to value the options granted during the following periods:

|                             | <b>Six<br/>months<br/>Ended<br/>September<br/>30,<br/>2009</b> | <b>Six months<br/>Ended<br/>September 30,<br/>2008</b> |
|-----------------------------|--|--|
| Expected life in years      | 4.83   | 4.08   |
| Risk-free interest rate     | 2.74%  | 3.16%  |
| Expected volatility         | 94.21%   | 82.76%   |
| Expected dividend yield     | 0  | 0  |
| Weighted-average fair value | \$ 0.60  | \$ 1.90  |

The expected life selected for options granted during the quarter represents the period of time that we expect our options to be outstanding based on historical data of option holder exercise and termination behavior for similar grants. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury rate over the expected life at the time of grant. Expected volatilities are based upon historical volatility of our stock. We estimate a forfeiture rate for stock awards of up to 14.5% based on the historical employee turnover rates.

The following table summarizes the activity related to our stock options during the six months ended September 30, 2009:

|   | <b>Number of<br/>shares</b> | <b>Weighted<br/>average<br/>exercise<br/>price</b> | <b>Weighted<br/>average<br/>remaining<br/>life<br/>in years</b> | <b>Aggregate<br/>intrinsic<br/>value</b> |
|---|-----------------------------|--|---|--|
| Options outstanding at March 31, 2009     | 2,134,500                   | \$ 3.93  | 4.02  | \$                                       |
| Options granted                           | 380,000                     | 0.83   |   |  |
| Options exercised                         |                             |  |   |  |
| Options cancelled                         | (25,500)                    | 3.03   |   |  |
| Options outstanding at September 30, 2009 | 2,489,000                   | \$ 3.47  | 3.72  | \$ 162,550                               |
| Exercisable at September 30, 2009         | 2,178,328                   | \$ 3.73  | 3.63  | \$ 78,683                                |

The aggregate intrinsic value for the outstanding options as of March 31, 2009 was zero because all the grants were out-of-money based on the closing price of our Company's common stock on March 31, 2009. As of September 30, 2009, we had approximately \$221,000 of unrecognized share-based compensation expense, net of estimated forfeitures, related to options that we expect to recognize over a weighted-average period of 1.41 years.

The following table summarizes the activity related to our restricted shares during the six months ended September 30, 2009:

|                           | <b>Number<br/>of<br/>Shares</b> | <b>Weighted<br/>average<br/>grant<br/>date fair<br/>value</b> | <b>Weighted<br/>average<br/>remaining<br/>life<br/>in years</b> | <b>Aggregate<br/>intrinsic<br/>value</b> |
|---------------------------|---------------------------------|---|---|--|
| Balance at March 31, 2009 | 14,000                          | \$ 3.15   | 0.16  | \$ 44,100                                |
| Shares granted            |                                 |   |   |  |
| Shares vested             | 14,000                          | 3.15  |   |  |
| Shares cancelled          |                                 |   |   |  |

Balance at September 30, 2009

**Table of Contents**

The aggregate intrinsic value represents the total pre-tax value of restricted stock that holders would have received (based on the closing price of our Company's common stock on the grant date) had all restricted stock vested and if we had issued common stock to the holders on the grant date. As of September 30, 2009, we had no unrecognized compensation expense.

**12. Savings and Retirement Plans**

We sponsor various plans for eligible employees in the United States, the United Kingdom (UK), and The Netherlands. Our retirement savings plan in the United States conforms to Section 401(k) of the Internal Revenue Code and participation is available to substantially all employees. We may also make discretionary contributions ratably to all eligible employees. We made contributions to the U.S. plan of \$68,000 and \$0 for the six months ended September 30, 2009 and 2008, respectively.

Our international subsidiaries have defined benefit retirement plans for eligible employees. These plans provide benefits based on the employee's years of service and compensation during the years immediately preceding retirement, termination, disability, or death, as defined in the plans. We froze the UK subsidiary's defined benefit plan on December 31, 2004. On March 10, 2005, we established a defined contribution plan for the UK subsidiary. As of April 1, 2005 we closed The Netherlands subsidiary's defined benefit retirement plan for new employees and established for them a defined contribution plan.

The cost for our defined benefit retirement plans in The Netherlands and the United Kingdom includes the following components for the three and six-month periods ended September 30, 2009 and 2008:

|                              | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|------------------------------|---------------------------|-------------|-------------------------|-------------|
|                              | <b>September 30,</b>      |             | <b>September 30,</b>    |             |
|                              | <b>2009</b>               | <b>2008</b> | <b>2009</b>             | <b>2008</b> |
| Gross service cost           | \$ 16,179                 | \$ 17,494   | \$ 31,586               | \$ 35,657   |
| Interest cost                | 23,614                    | 24,778      | 46,053                  | 50,518      |
| Expected return on assets    | 1,306                     | 4,187       | 2,609                   | 8,520       |
| Amortization                 | (113)                     | 1,044       | (221)                   | 2,127       |
| <br>                         |                           |             |                         |             |
| Net periodic retirement cost | \$ 40,986                 | \$ 47,503   | \$ 80,027               | \$ 96,822   |

Major assumptions used in the above calculations include:

|   | <b>Six months Ended</b> |             |
|---|-------------------------|-------------|
|   | <b>September 30,</b>    |             |
|   | <b>2009</b>             | <b>2008</b> |
| Discount rate                                     | 6.60-6.70%              | 6.10-6.70%  |
| Expected return on assets                         | 5.00-6.60%              | 5.00-6.10%  |
| Expected rate of increase in future compensation: |                         |             |
| General   | 3%                      | 3%          |
| Individual  | 0-3%                    | 0-3%        |

The United Kingdom pension plan is in an over funded position and its funded status is shown as a prepaid pension asset. The Netherlands pension plan is in an under funded position and its funded status is shown as accrued pension liability.

We made aggregate contributions of approximately \$146,000 and \$144,000, respectively, during the six months ended September 30, 2009 and 2008 to the two defined plans.

**13. Foreign Currency Translation**

We translate all assets and liabilities using period-end exchange rates. We translate statements of operations items using average exchange rates for the period. We record the resulting translation adjustment within accumulated other comprehensive loss, a separate component of shareholders' equity. We recognize foreign currency transaction gains



and losses in our consolidated statements of operations, including unrealized gains and losses on short-term intercompany obligations using period-end exchange rates. We recognize unrealized gains and losses on long-term intercompany obligations within accumulated other comprehensive loss, a separate component of shareholders' equity.

**Table of Contents**

We recognize exchange gains and losses primarily as a result of fluctuations in currency rates between the U.S. dollar (the functional reporting currency) and the Euro and British pound (currencies of our subsidiaries), as well as their effect on the dollar denominated intercompany obligations between us and our foreign subsidiaries. All intercompany balances are revolving in nature and we do not deem them to be long-term balances. For the three months ended September 30, 2009 and 2008, we recognized foreign currency exchange gain (loss) of \$(7,365) and \$5,038, respectively. For the six months ended September 30, 2009 and 2008, we recognized foreign currency exchange loss of \$14,697 and \$732, respectively.

**14. Business Segment Information**

ASC 280, *Segment Reporting*, establishes disclosure standards for segments of a company based on management's approach to defining operating segments. In accordance with the objective and basic principles of the standard we aggregate our operating segments into one reportable segment.

Information regarding our geographic operations for the three- and six-month periods ended September 30, 2009 and 2008 is as follows:

|  | <b>United<br/>States</b> | <b>The<br/>Netherlands</b> | <b>United<br/>Kingdom</b> | <b>Consolidated</b> |
|--|--------------------------|----------------------------|---------------------------|---------------------|
| <b>Three months ended September 30, 2009</b> |                          |                            |                           |                     |
| Sales to customers                           | \$1,503,716              | \$1,054,748                | \$ 428,011                | \$2,986,475         |
| <b>Six months ended September 30, 2009</b>   |                          |                            |                           |                     |
| Sales to customers                           | \$2,963,454              | \$2,065,238                | \$ 783,712                | \$5,812,404         |
| Long-lived assets at September 30, 2009      | 3,581,315                | 759,444                    | 90,753                    | 4,431,512           |
| <b>Three months ended September 30, 2008</b> |                          |                            |                           |                     |
| Sales to customers                           | \$2,218,587              | \$1,179,408                | \$ 522,521                | \$3,920,516         |
| <b>Six months ended September 30, 2008</b>   |                          |                            |                           |                     |
| Sales to customers                           | \$4,431,684              | \$2,905,437                | \$1,109,017               | \$8,446,138         |
| Long-lived assets at September 30, 2008      | 4,550,692                | 772,626                    | 38,714                    | 5,362,032           |

Accounting policies of the operations in the various geographic areas are the same as those described in Note 1. Sales attributed to each geographic area are net of intercompany sales. No single customer represents 10% or more of our consolidated net sales. Long-lived assets consist of property and equipment, intangible assets and certain other assets.

**15. Income Tax Expense**

During the three months ended September 30, 2009 and 2008, we recorded income tax expense of approximately \$15,000 and \$26,000, respectively. During the six months ended September 30, 2009 and 2008, we recorded income tax expense of approximately \$23,000 and \$38,000, respectively. The income tax expense we recorded is attributed primarily to our operations in The Netherlands. We cannot use our U.S. net operating loss carry forwards to offset taxable income in foreign jurisdictions.

Effective April 1, 2007, we adopted ASC 740, *Income Taxes*, which prescribes a recognition threshold and a measurement attribute for financial statement recognition of tax positions we take or expect to take in a tax return. It is management's responsibility to determine whether it is more-likely-than-not that a taxing authority will sustain a tax

position upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. At adoption on April 1, 2007, we had no unrecognized tax benefits which needed adjustment. We reviewed all income tax positions taken or that we expect to take for all open tax years and determined that our income tax positions are appropriately

**Table of Contents**

stated and supported for all open years. Accordingly, adoption of ASC 740 did not have a significant effect on our consolidated financial statements.

Under our accounting policies we would recognize interest and penalties accrued on unrecognized tax benefits as well as interest received from favorable tax settlements within income tax expense. At the adoption date of April 1, 2007, we recognized no interest or penalties related to uncertain tax positions. As of September 30, 2009, we recorded no accrued interest or penalties related to uncertain tax positions.

The fiscal tax years 2005 through 2008 remain open to examination by the Internal Revenue Service and various state taxing jurisdictions to which we are subject. In addition, we are subject to examination by certain foreign taxing authorities for which the fiscal years 2007 through 2009 remain open for examination.

**16. Recently Issued Accounting Standards**

In August 2009, the FASB issued Accounting Standards Update No. 2009-05, *Measuring Liabilities at Fair Value (ASU 2009-05)*. This Standards Update provides amendments to ASC Topic 820, *Fair Value Measurements and Disclosure* for the fair value measurement of liabilities when a quoted price in an active market is not available. ASU 2009-05 is effective for reporting periods beginning after August 28, 2009. This ASU is effective for our third quarter of our fiscal 2010 ending December 31, 2009. The adoption is not expected to have an impact on our financial position or results of operations.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Codification and the Hierarchy of Generally Accepted Accounting Principles*. SFAS 168 replaced FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, and establishes the FASB Accounting Standards Codification™ (Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with generally accepted accounting principles (GAAP). SFAS 168 was effective for interim and annual periods ending after September 15, 2009. We are now using the new Codification when referring to GAAP in our interim financial statements for the period ended September 30, 2009.

The adoption did not have an impact on our financial position or results of operations.

In May 2009, the FASB issued ASC 855, *Subsequent Events*. This Statement incorporates guidance into accounting literature that was previously addressed only in auditing standards. The statement refers to subsequent events that provide additional evidence about conditions that existed at the balance-sheet date as recognized subsequent events. Subsequent events which provide evidence about conditions that arose after the balance sheet date but prior to the issuance of the financial statements are referred to as non-recognized subsequent events. It also requires companies to disclose the date through which subsequent events have been evaluated and whether this date is the date the financial statements were issued or the date the financial statements were available to be issued. We adopted this standard effective April 1, 2009 see Note 17.

In December 2008, the FASB issued additional guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. The requirements, effective for fiscal years beginning after December 15, 2009, pertain only to the disclosures and do not affect the accounting for defined benefit pensions or other postretirement plans. We do not anticipate adoption of the new guidance to have an impact on our financial position or results of operations.

**17. Subsequent events**

We evaluated all subsequent events through November 2, 2009, the filing date of this Form 10-Q with the Securities and Exchange Commission, to ensure that this Form 10-Q includes appropriate disclosure of events both recognized in the financial statements as of September 30, 2009, and events which occurred subsequent to September 30, 2009 but were not recognized in the financial statements. As of November 2, 2009, we had no subsequent events which required recognition in the financial statements.

On October 30, 2009 we entered into a one-year business loan agreement with Venture Bank. The agreement provides for a credit line of up to \$2 million secured by the assets of our company. We may borrow up to 50% (to a maximum of \$500,000) of the value of our eligible inventory on hand and 80% of the value of our eligible U.S. accounts receivable; provided, however, our total liabilities, inclusive of the amount borrowed, may not exceed our tangible net worth. To be eligible to borrow any amount, we must maintain a minimum tangible net worth of \$5 million. Interest on the loan is charged at a per annum rate of the greater of 7.5% or one percentage point over the prime rate.



**Table of Contents**

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

**We recommend that you read this Report on Form 10-Q in conjunction with our Annual Report on Form 10-K for the year ended March 31, 2009.**

**Forward-looking Statements**

This Form 10-Q contains forward-looking statements relating to projections, plans, objectives, estimates, and other statements of future economic performance. These forward-looking statements are subject to known and unknown risks and uncertainties relating to our future performance that may cause our actual results, performance, or achievements, or industry results, to differ materially from those expressed or implied in any such forward-looking statements. Our business operates in highly competitive markets and is subject to changes in general economic conditions, competition, reimbursement levels, customer and market preferences, government regulation, the impact of tax regulation, foreign exchange rate fluctuations, the degree of market acceptance of products, the uncertainties of potential litigation, as well as other risks and uncertainties detailed elsewhere herein and in our Annual Report filed on Form 10-K for the year ended March 31, 2009.

We do not undertake, nor assume obligation, to update any forward-looking statement that we may make from time to time.

**Critical Accounting Policies**

We prepare our consolidated financial statements in accordance with U.S. generally accepted accounting principles, which require us to make estimates and assumptions in certain circumstances that affect amounts reported. In preparing these consolidated financial statements, we have made our best estimates and judgments of certain amounts, giving due consideration to materiality.

We have identified certain accounting policies that we consider particularly important for the portrayal of our results of operations and financial position and which may require the application of a higher level of judgment by our management, and as a result are subject to an inherent level of uncertainty. These are characterized as critical accounting policies and address revenue recognition, accounts receivable, inventories, foreign currency translation and transactions, impairment of long-lived assets, share-based compensation, defined benefit pension plans and income taxes, each of which is described in our Annual Report on Form 10-K for the year ended March 31, 2009. Based upon our review, we have determined that these policies remain our most critical accounting policies for the six-month period ended September 30, 2009, and we have made no changes to these policies during fiscal 2010.

**Overview**

We are a medical device company that develops, manufactures and markets innovative, proprietary products for the treatment of voiding dysfunctions. Our primary focus is on two products: our Urgent PC<sup>®</sup> system, which we believe is the only FDA-approved minimally invasive, office-based neuromodulation therapy for the treatment of urinary urgency, urinary frequency, and urge incontinence symptoms often associated with overactive bladder (OAB); and Macroplastique<sup>®</sup>, a urethral bulking agent for the treatment of adult female stress urinary incontinence primarily due to intrinsic sphincter deficiency (ISD). We believe physicians prefer our products because they offer an effective therapy for the patient, can be administered in office-based settings and, to the extent reimbursement is in place, provide the physicians a new recurring revenue stream. We believe patients prefer our products because they are minimally invasive treatment alternatives that do not have the side effects associated with pharmaceutical treatment options nor the morbidity associated with surgery.

Outside of the U.S., our Urgent PC is also approved for treatment of fecal incontinence, and Macroplastique is also approved for treatment of male stress incontinence and vesicoureteral reflux.

Our sales performance has been greatly influenced by the sales in the U.S. of our Urgent PC system. Starting in the second half of fiscal 2009, sales over corresponding year-ago periods of our Urgent PC system declined and continued to do so in the first half of fiscal 2010 because of reimbursement-related issues, though sales have stabilized at around \$1 million per quarter in each of the last two quarters. The American Medical Association has advised the medical community that their previously recommended listed CPT code for reimbursement of Urgent PC treatments should be replaced with an unlisted code. As a result, some third-party insurance carriers are now denying reimbursement while certain other carriers are reassessing their coverage and reimbursement policies for Urgent PC treatments. However, many other third party payers, under a published positive coverage policy or on a case-by-case basis, continue to

provide reimbursement for Urgent PC treatments.

A major part of our strategy, supported by publication of clinical studies in peer-reviewed journals in the U.S., is to obtain a listed CPT code for percutaneous tibial nerve stimulation, and expand third-party reimbursement coverage of Urgent PC

**Table of Contents**

treatments in the U.S. Additionally, we continue to implement a comprehensive program designed to educate Medicare carriers and private payer medical directors around the country about the benefits and clinical study results of Urgent PC. The medical directors have asked for additional peer-reviewed publications in U.S. medical journals and to date four new articles have been published. We understand that a manuscript for the results of the second phase of our earlier OrBIT clinical trial is tentatively scheduled to appear in the January 2010 issue of *The Journal of Urology*® and the results of our 12-week SUMiT trial are expected to be published in the April 2010 issue of this journal.

Our overall goal is to receive a listed CPT code in February 2010 which would become effective in January 2011. We believe the availability of a listed CPT code will encourage broader use of our Urgent PC. We expect that Urgent PC sales will not return to recent historical sales levels in the U.S. until after a new listed CPT code is assigned and payers create coverage policies that provide adequate reimbursement.

Our results are also impacted by the steadily increasing sales in the U.S. of our Macroplastique product because of our increased sales and marketing focus. Sales of our Macroplastique product in the U.S., accounting for \$949,000 through six months of our current fiscal year, have about doubled in each quarter over the corresponding year-ago quarter.

Our net loss increased because of a decline in sales and a decline in gross margin, primarily because of lower capacity utilization, offset partially by a reduction in operating expenses.

**Results of Operations****Three and six months ended September 30, 2009 compared to three and six months ended September 30, 2008**

**Net Sales:** During the three months ended September 30, 2009, net sales of \$3.0 million represented a \$0.9 million, or a 24% decrease, over net sales of \$3.9 million for the three months ended September 30, 2008. Excluding the translation impact of fluctuations in foreign currency exchange rates, sales decreased by approximately 21%. During the six months ended September 30, 2009, net sales of \$5.8 million represented a \$2.6 million, or a 31% decrease, over net sales of \$8.4 million for the six months ended September 30, 2008. Excluding the translation impact of fluctuations in foreign currency exchange rates, sales decreased by approximately 27%.

Sales to customers in the U.S. during the three months ended September 30, 2009 totaled \$1.5 million, representing a \$715,000, or a 32% decrease, over net sales of \$2.2 million for the three months ended September 30, 2008. During the six months ended September 30, 2009 sales to customers in the U.S. totaled \$3.0 million, representing a 33% decrease, over net sales of \$4.4 million for the six months ended September 30, 2008.

Sales in the U.S. of our Urgent PC product, decreased 51% to \$960,000 for three months ended September 30, 2009, from \$2.0 million for the same year-ago period, and for the six months ended September 30, 2009 decreased 50% to \$2.0 million from \$4.0 million for the same year-ago period. The trend in decline of our Urgent PC sales over corresponding year-ago periods began in the second half of fiscal 2009 due to reimbursement related issues. Sales have stabilized at around \$1 million per quarter in each of the last two quarters.

Sales in the U.S. of our Macroplastique product, increased 108% to \$528,000 for three months ended September 30, 2009, from \$254,000 for the same year-ago period, and for the six months ended September 30, 2009 increased 115% to \$949,000 from \$441,000 for the same year-ago period. Sales of our Macroplastique product have about doubled in each quarter over the corresponding year-ago quarter because of our increased sales and marketing focus.

Sales to customers outside the U.S. for the three months ended September 30, 2009 and 2008 were \$1.5 million and \$1.7 million, respectively, a decrease of 13%. Excluding the translation impact of fluctuations in foreign currency exchange rates, sales decreased by approximately 5%. For the six months ended September 30, 2009 and 2008 sales were \$2.8 million and \$4.0 million, respectively, a decrease of 29%. Excluding the translation impact of fluctuations in foreign currency exchange rates, sales decreased by approximately 20%. The sales decrease is mainly attributed to increased competition from a newly-introduced product against our Macroplastique product, inventory buildup in the last fiscal year at one of our European distributors, the current year first fiscal quarter change of a distributor in an European country, and the discontinuation in the United Kingdom of our I-Stop urethral sling product which accounted for approximately \$101,000 in sales for the six months ended September 30, 2008 and \$191,000 in sales in fiscal 2009. We believe the distributor-related issues are now resolved.



Gross Profit: Gross profit was \$2.5 million and \$3.4 million for the three months ended September 30, 2009 and 2008, respectively, or 82% and 86% of net sales in the respective periods. Gross profit was \$4.7 million and \$7.2 million for the six months ended September 30, 2009 and 2008, respectively, or 81% and 85% of net sales in the respective periods. We attribute the lower gross profit percentage in the three and six months ended September 30, 2009 primarily to a decrease in

**Table of Contents**

manufacturing capacity utilization as a result of the decreased sales and the negative impact of changes in the currency exchange rates from our foreign currency-denominated sales.

**General and Administrative Expenses (G&A):** G&A expenses decreased \$205,000 from \$918,000 during the three months ended September 30, 2008 to \$713,000 during the same period in 2009. Expenses decreased \$395,000 from \$2.0 million during the six months ended September 30, 2008 to \$1.6 million during the same period in 2009. G&A expenses decreased primarily because of a decrease in personnel-related costs and professional and consulting fees. We have implemented concentrated efforts to reduce expenses until reimbursement in the U.S. for Urgent PC recovers and the economy improves.

**Research and Development Expenses (R&D):** R&D expenses increased from \$328,000 during the three months ended September 30, 2008 to \$436,000 during the same period in 2009. Expenses increased from \$733,000 during the six months ended September 30, 2008 to \$964,000 during the same period in 2009. The increase is attributed primarily to an increase in spending for clinical studies. We have undertaken clinical studies that we anticipate may assist us in obtaining a specific listed CPT code that will encourage broader use of our Urgent PC. We spent approximately \$1.3 million in fiscal 2009, have spent approximately \$0.3 million in the six months ended September 30, 2009 and anticipate spending approximately \$0.2 million in the remainder of the current fiscal year for such clinical studies.

**Selling and Marketing Expenses (S&M):** S&M expenses decreased from \$2.5 million during the three months ended September 30, 2008 to \$2.0 million during the same period in 2009. Expenses decreased from \$5.1 million during the six months ended September 30, 2008 to \$4.0 million during the same period in 2009. We attribute the decrease to a \$276,000 decrease in commissions due to the decrease in sales, \$186,000 decrease in travel costs, \$261,000 decrease in compensation-related costs, a \$59,000 decrease in consultancy costs, mainly reimbursement related, and decreased cost to support our marketing activities. Although we have maintained our assembled U.S. sales force and redirected some of their effort to our Macroplastique product line until reimbursement for Urgent PC stabilizes, we have taken steps to control other sales and marketing expenses.

**Amortization of Intangibles:** Amortization of intangibles was \$212,000 and \$211,000 for the three months ended September 30, 2009 and 2008, respectively, and was \$423,000 and \$422,000 for the six months ended September 30, 2009 and 2008, respectively. In April 2007, we acquired from CystoMedix, Inc., certain intellectual property assets related to the Urgent PC system for \$4.7 million, which we are amortizing over six years.

**Other Income (Expense):** Other income (expense) includes interest income, interest expense, foreign currency exchange gains and losses and other non-operating costs when incurred. Net other income was \$17,000 and \$57,000 for the three months ended September 30, 2009 and 2008, respectively, and was \$31,000 and \$120,000 for the six months ended September 30, 2009 and 2008, respectively. The decline in net other income is attributed primarily to the decline in interest income on lower cash balance and interest rates.

We recognize exchange gains and losses primarily as a result of fluctuations in currency rates between the U.S. dollar (the functional reporting currency) and the Euro and British pound (currencies of our subsidiaries), as well as their effect on the dollar denominated short-term intercompany obligations between us and our foreign subsidiaries. We recognized foreign currency exchange gain (loss) of \$(7,000) and \$5,000 for the three months ended September 30, 2009 and 2008, respectively, and \$(15,000) and \$(1,000) for the six months ended September 30, 2009 and 2008, respectively.

**Income Tax Expense:** During the three months ended September 30, 2009 and 2008, we recorded income tax expense of \$15,000 and \$26,000, respectively, and \$23,000 and 38,000 for the six months ended September, 2009 and 2008, respectively. We cannot use our U.S. net operating loss carry forwards to offset taxable income in foreign jurisdictions.

**Non-GAAP Financial Measures:** The following table reconciles our financial results calculated in accordance with accounting principles generally accepted in the U.S. (GAAP) to non-GAAP financial measures that exclude non-cash charges for share-based compensation, and depreciation and amortization expenses from gross profit, operating expenses and operating loss. The non-GAAP financial measures used by management and disclosed by us are not a substitute for, or superior to, financial measures and consolidated financial results calculated in accordance with GAAP, and you should carefully evaluate our reconciliations to non-GAAP. We may calculate our non-GAAP financial measures differently from similarly titled measures used by other companies. Therefore, our non-GAAP

financial measures may not be comparable to those used by other companies. We have described the reconciliations of each of our non-GAAP financial measures above to the most directly comparable GAAP financial measures. We use these non-GAAP financial measures, and in particular non-GAAP operating loss, for internal managerial purposes because we believe such measures are one important indicator of the strength and the performance of our business as they

**Table of Contents**

provide a link to operating cash flow. We also believe that analysts and investors use such measures to evaluate the overall operating performance of companies in our industry, including as a means of comparing period-to-period results and as a means of evaluating our results with those of other companies.

Our non-GAAP operating loss of approximately \$475,000 for the three months ended September 30, 2009 was greater than the \$98,000 operating loss in same period in fiscal 2009. Our non-GAAP operating loss was approximately \$1,390,000 for the six months ended September 30, 2009 compared to an operating income of \$8,000 in same period fiscal in 2009. We attribute the increased operating loss primarily to the decrease in sales and a lower gross margin rate, offset partially by a decrease in cash operating expenses.

|                                  | <b>Three Months Ended</b> |              | <b>Six Months Ended</b> |              |
|----------------------------------|---------------------------|--------------|-------------------------|--------------|
|                                  | <b>September 30,</b>      |              | <b>September 30,</b>    |              |
|                                  | <b>2009</b>               | <b>2008</b>  | <b>2009</b>             | <b>2008</b>  |
| <b>Gross Profit</b>              |                           |              |                         |              |
| GAAP gross profit                | \$ 2,451,401              | \$ 3,371,317 | \$ 4,725,360            | \$ 7,188,972 |
| % of sales                       | 82%                       | 86%          | 81%                     | 85%          |
| Share-based compensation         | 4,903                     | 8,879        | 18,448                  | 25,253       |
| Depreciation expense             | 14,150                    | 13,057       | 28,299                  | 25,847       |
| Non-GAAP gross profit            | 2,470,454                 | 3,393,253    | 4,772,107               | 7,240,072    |
| <b>Operating Expenses</b>        |                           |              |                         |              |
| GAAP operating expenses          | 3,328,495                 | 3,962,936    | 6,973,962               | 8,238,179    |
| Share-based compensation         | 113,909                   | 198,131      | 273,014                 | 464,748      |
| Depreciation expense             | 57,546                    | 62,104       | 115,623                 | 119,161      |
| Amortization expense             | 211,503                   | 210,966      | 423,316                 | 421,941      |
| Non-GAAP operating expenses      | 2,945,537                 | 3,491,735    | 6,162,009               | 7,232,329    |
| <b>Operating Loss</b>            |                           |              |                         |              |
| GAAP operating loss              | (877,094)                 | (591,619)    | (2,248,602)             | (1,049,207)  |
| Share-based compensation         | 118,812                   | 207,010      | 291,462                 | 490,001      |
| Depreciation expense             | 71,696                    | 75,161       | 143,922                 | 145,008      |
| Amortization expense             | 211,503                   | 210,966      | 423,316                 | 421,941      |
| Non-GAAP operating income (loss) | \$ (475,083)              | \$ (98,482)  | \$ (1,389,902)          | \$ 7,743     |

**Liquidity and Capital Resources***Cash Flows.*

At September 30, 2009, our cash and cash equivalent and short-term investments balances totaled \$5.8 million.

At September 30, 2009, we had working capital of approximately \$6.4 million. For the six months ended September 30, 2009, we used \$2.0 million of cash in operating activities, compared to \$0.3 million of cash used in the same period a year ago. We attribute the increase in cash used in operating activities primarily to the decrease in sales, and a decrease of the gross profit rate, offset partially by a decrease in cash operating expenses.

For the six months ended September 30, 2009 we used approximately \$61,000 to purchase property, plant and equipment compared with approximately \$130,000 for the same period a year ago.

For the six months ended September 30, 2008 we used cash in financing activities of approximately \$456,000 to repay debt obligations. In the third quarter of fiscal 2009 we fully retired the debt and used no cash in financing activities

during the six months ended September 30, 2009.

**Table of Contents***Sources of Liquidity.*

Uroplasty BV, our subsidiary, has an agreement with Rabobank of The Netherlands for a 500,000 (approximately \$730,000) credit line. The bank charges interest on the loan at the rate of one percentage point over the Rabobank base interest rate (4.85% base rate on September 30, 2009), subject to a minimum interest rate of 3.5% per annum. At September 30, 2009, we had no borrowings outstanding on this credit line.

On October 30, 2009 we renewed our credit line with Venture Bank. The agreement provides for a credit line of up to \$2 million secured by the assets of our company. We may borrow up to 50% (to a maximum of \$500,000) of the value of our eligible inventory on hand and 80% of the value of our eligible U.S. accounts receivable; provided, however, our total liabilities, inclusive of the amount borrowed, may not exceed our tangible net worth. To be eligible to borrow any amount, we must maintain a minimum tangible net worth of \$5 million. Interest on the loan is charged at a per annum rate of the greater of 7.5% or one percentage point over the prime rate.

We believe we have sufficient liquidity to meet our needs over the next twelve months. However, we may need to raise additional financing to support our operations and planned growth activities in the future as we have yet to achieve profitability and generate positive cash flows. To achieve profitability, we must generate substantially more revenue than we have this year or in prior years. Our ability to achieve significant revenue growth will depend, in large part, on our ability to achieve widespread market acceptance for our products and successfully expand our business in the U.S., which in turn may be partially dependent upon re-establishing broad reimbursement for our Urgent PC product and successfully demonstrating the superiority of our Macroplastique product to clinicians. We cannot guarantee that we will be entirely successful in either of these pursuits. If we are unable to raise the needed funds, we may need to curtail our operations including product development, clinical studies and sales and marketing activities. This would adversely impact our future business and prospects. Ultimately, we will need to achieve profitability and generate positive cash flows from operations to meet our cash needs and grow our business.

*Commitments and Contingencies.*

We discuss our commitments and contingencies in our Annual Report on Form 10-K for the year ended March 31, 2009. There have been no significant changes in our commitments for capital expenditure and contractual obligations since March 31, 2009.

We expect to continue to incur significant costs for clinical studies to support our effort to obtain a specific listed CPT code that we anticipate will encourage broader use of our Urgent PC System in the U.S. We expect that in fiscal 2010 we will spend approximately \$0.5 million for such clinical studies. We also expect to continue to incur significant expenses to support our U.S. sales and marketing organization, and for regulatory activities.

**ITEM 3. Quantitative and Qualitative Disclosures about Market Risk**

Not applicable due to our status as a Smaller Reporting Company.

**ITEM 4. Controls and Procedures***Disclosure Controls and Procedures.*

Under the supervision and with the participation of our management, including, our President and Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e)) under the Securities Exchange Act of 1934 (the Exchange Act ). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective in ensuring that the 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 Chief Executive Officer and Chief Financial Officer, in a manner that allows timely decisions regarding required disclosure.

*Internal Control Over Financial Reporting.*

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2009, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

None.

**ITEM 1A. Risk Factors**

There have been no material changes from the risk factors set forth in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**ITEM 3. Defaults upon Senior Securities**

None.

**ITEM 4. Submission of Matters to a Vote of Security Holders**

On September 15, 2009 we held our 2009 Annual Meeting. At the meeting the shareholders approved a proposal to reelect as directors Lee A. Jones and David B. Kaysen to three-year terms expiring on the date of our 2012 annual shareholders meeting. A summary of the voting is as follows:

|  | <b>Votes<br/>For</b> | <b>Votes<br/>Against</b> | <b>Votes<br/>Withheld</b> | <b>Abstentions</b> | <b>Broker<br/>Non-Votes</b> |
|--|----------------------|--------------------------|---------------------------|--------------------|-----------------------------|
| <b>Proposal 1 Election of Directors:</b> |                      |                          |                           |                    |                             |
| Lee A. Jones                             | 13,226,616           |                          | 147,631                   |                    |                             |
| David B. Kaysen                          | 13,224,996           |                          | 149,251                   |                    |                             |

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

Exhibits

10.17 Business Loan Agreement and related Promissory Note dated October 30, 2009 with Venture Bank

31.1 Certifications by the Chief Executive Officer and the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certifications by the Chief Executive Officer and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (this Exhibit is furnished pursuant to SEC rules, but is deemed not filed )

**Table of Contents**

**SIGNATURES**

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

UROPLASTY, INC.

Date: November 2, 2009

By: /s/ DAVID B. KAYSEN

David B. Kaysen  
President and Chief Executive Officer

Date: November 2, 2009

By: /s/ MAHEDI A. JIWANI

Mahedi A. Jiwani  
Chief Financial Officer  
Page 21