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BSD MEDICAL CORP
Form 10-Q
January 09, 2008

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended November 30, 2007

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

For the transition period from _____ to _____

Commission File No. 001-32526

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

Delaware
(State or other jurisdiction of
incorporation or organization)

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

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

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer or non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one): Large Accelerated Filer Accelerated Filer Non-accelerated Filer

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

As of January 9, 2008, there were 21,288,333 shares of the Registrant's common stock, \$0.001 par value per share, outstanding.

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BSD MEDICAL CORPORATION
FORM 10-Q

FOR THE QUARTER ENDED NOVEMBER 30, 2007

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

BSD MEDICAL CORPORATION
Condensed Balance Sheets
(Unaudited)

| | | |
|--------|----------------------|--------------------|
| ASSETS | November 30, 2007 | August 31, 2007 |
|--------|----------------------|--------------------|

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| | | |
|--|---------------|---------------|
| ----- | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 731,513 | \$ 416,540 |
| Investments | 15,860,611 | 19,090,118 |
| Accounts receivable, net of allowance for doubtful accounts of \$20,000 | 491,130 | 203,267 |
| Related party trade accounts receivable | 1,036,247 | 488,200 |
| Income tax receivable | 2,162,022 | 1,759,995 |
| Inventories, net | 1,602,503 | 1,510,067 |
| Deferred tax asset | - | 387,000 |
| Other current assets | 119,776 | 127,003 |
| | ----- | |
| Total current assets | 22,003,802 | 23,982,190 |
| Property and equipment, net | 1,451,066 | 271,077 |
| Patents, net | 39,870 | 19,373 |
| Deferred tax asset | - | 69,000 |
| | ----- | |
| | \$ 23,494,738 | \$ 24,341,640 |
| | ===== | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 269,305 | \$ 235,676 |
| Accrued liabilities | 560,732 | 633,090 |
| Customer deposits | 83,065 | 214,638 |
| Deferred revenue - current portion | 23,392 | 26,115 |
| | ----- | |
| Total current liabilities | 936,494 | 1,109,519 |
| Deferred revenue - net of current portion | 43,334 | 48,333 |
| | ----- | |
| Total liabilities | 979,828 | 1,157,852 |
| | ----- | |
| 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, 40,000,000 shares authorized, 21,312,664 and 21,297,446 shares issued | 21,313 | 21,298 |
| Additional paid-in capital | 26,689,279 | 26,373,637 |
| Treasury stock, 24,331 shares at cost | (234) | (234) |
| Other comprehensive loss | (729,360) | (360,760) |
| Accumulated deficit | (3,466,088) | (2,850,153) |
| | ----- | |
| Total stockholders' equity | 22,514,910 | 23,183,788 |
| | ----- | |
| | \$ 23,494,738 | \$ 24,341,640 |
| | ===== | |

See accompanying notes to condensed financial statements

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BSD MEDICAL CORPORATION
Condensed Statements of Operations
(Unaudited)

| | Three Months Ended November 30, | |
|--|------------------------------------|--------------|
| | 2007 | 2006 |
| Revenues: | | |
| Sales | \$ 479,703 | \$ 648,611 |
| Sales to related parties | 908,025 | 16,044 |
| | ----- | |
| Total revenues | 1,387,728 | 664,655 |
| | ----- | |
| Operating costs and expenses: | | |
| Cost of sales | 162,981 | 436,625 |
| Cost of related party sales | 277,874 | 12,630 |
| Research and development | 337,353 | 332,079 |
| Selling, general and administrative | 1,393,947 | 1,556,441 |
| | ----- | |
| Total operating costs and expenses | 2,172,155 | 2,337,775 |
| | ----- | |
| Loss from operations | (784,427) | (1,673,120) |
| | ----- | |
| Other income (expense): | | |
| Interest income | 189,348 | 370,213 |
| Other expense | (63,856) | (27,732) |
| | ----- | |
| Total other income (expense) | 125,492 | 342,481 |
| | ----- | |
| Loss before income taxes | (658,935) | (1,330,639) |
| Income tax benefit | 43,000 | 468,968 |
| | ----- | |
| Net loss | (615,935) | (861,671) |
| Other comprehensive income (loss) - unrealized gain (loss) on investments, net of income tax | (368,600) | 30,869 |
| | ----- | |
| Net comprehensive loss | \$ (984,535) | \$ (830,802) |
| | ===== | |
| Loss per common share: | | |
| Basic | \$ (0.03) | \$ (0.04) |
| | ===== | |
| Diluted | \$ (0.03) | \$ (0.04) |
| | ===== | |

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Weighted average number of shares outstanding:

| | | |
|---------|------------|------------|
| Basic | 21,311,000 | 21,036,000 |
| Diluted | 21,311,000 | 21,036,000 |

See accompanying notes to condensed financial statements

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BSD MEDICAL CORPORATION Condensed Statements of Cash Flows (Unaudited)

| | Three Months Ended November 30, | |
|---|------------------------------------|--------------|
| | 2007 | 2006 |
| Cash flows from operating activities: | | |
| Net loss | \$ (615,935) | \$ (861,671) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 26,373 | 21,116 |
| Stock-based compensation | 158,630 | 234,210 |
| Stock issued for services | 30,000 | - |
| Provision for doubtful accounts | - | 83,700 |
| Decrease (increase) in: | | |
| Receivables | (835,910) | 51,074 |
| Income tax receivable | (211,000) | (367,967) |
| Inventories | (92,436) | (107,983) |
| Deferred tax assets | 168,000 | (101,000) |
| Other current assets | 7,227 | 7,968 |
| Increase (decrease) in: | | |
| Accounts payable | 33,629 | 124,860 |
| Accrued liabilities | (72,358) | (121,131) |
| Customer deposits | (131,573) | - |
| Deferred revenue | (7,722) | (11,286) |
| Income taxes payable | - | (1,500,000) |
| | ----- | ----- |
| Net cash used in operating activities | (1,543,075) | (2,548,110) |
| | ----- | ----- |
| Cash flows from investing activities: | | |
| Sale of investments | 3,072,907 | 1,666,755 |
| Purchase of property and equipment | (1,205,892) | (23,812) |
| Increase in patents | (20,967) | - |
| | ----- | ----- |
| Net cash provided by investing activities | 1,846,048 | 1,642,943 |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Proceeds from the sale of common stock | 12,000 | - |
| | ----- | ----- |
| Net increase (decrease) in cash and cash equivalents | 314,973 | (905,167) |
| Cash and cash equivalents, beginning of period | 416,540 | 2,179,094 |
| | ----- | ----- |

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| | | | | |
|--|----|---------|----|-----------|
| Cash and cash equivalents, end of period | \$ | 731,513 | \$ | 1,273,927 |
| | | ===== | | |

See accompanying notes to condensed financial statements

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BSD MEDICAL CORPORATION Notes to Condensed Financial Statements (Unaudited)

Note 1. Basis of Presentation

The accompanying unaudited condensed balance sheets of BSD Medical Corporation (the "Company") as of November 30, 2007 and August 31, 2007 and the related unaudited condensed statements of operations and of cash flows for the three months ended November 30, 2007 and 2006 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 footnotes required by U.S. generally accepted accounting principles for complete financial statements. These condensed financial statements should be read in conjunction with the notes thereto, and the financial statements and notes thereto included in our annual report on Form 10-K for the year ended August 31, 2007.

All adjustments (consisting only of normal recurring adjustments) necessary for the fair presentation of our financial position as of November 30, 2007 and August 31, 2007 and our results of operations and cash flows for the three months ended November 30, 2007 and 2006 have been included. The results of operations for the three months ended November 30, 2007 may not be indicative of the results for the year ending August 31, 2008.

Note 2. Recent Accounting Pronouncements

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

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations. This statement replaces SFAS No. 141, Business Combinations and applies to all transactions or other events in which an entity (the acquirer) obtains control of one or more businesses (the acquiree), including those sometimes referred to as "true mergers" or "mergers of equals" and combinations achieved without the transfer of consideration. This statement establishes principles and requirements for how the acquirer: a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and c) determines what information to disclose to enable users

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of the financials statements to evaluate the nature and financial effects of the business combination. This statement will be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, or our fiscal year beginning September 1, 2009. Earlier adoption is prohibited. We currently are unable to determine what impact the future application of this pronouncement may have on our financial statements.

In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements. This statement applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, and amends Accounting Research Bulletin ("ARB") 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It also amends certain of ARB 51's

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consolidation procedures for consistency with the requirements of SFAS No. 141 (revised 2007). This statement will be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, or our fiscal year beginning September 1, 2009. Earlier adoption is prohibited. We currently are unable to determine what impact the future application of this pronouncement may have on our financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS No. 159 apply only to entities that elect the fair value option. However, the amendment to SFAS No. 115 Accounting for Certain Investments in Debt and Equity Securities applies to all entities with available-for-sale and trading securities. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007, or our fiscal year beginning September 1, 2008. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provision of SFAS No. 157, Fair Value Measurements. We have not elected early adoption of this statement, and do not expect the adoption of this statement will have a material impact on our financial statements.

In September 2006, the FASB issued SFAS Statement No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. This new standard will require employers to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare and other postretirement plans in their financial statements. We adopted SFAS No. 158 on September 1, 2007, with no material impact on our financial statements since we currently do not sponsor a defined benefit pension or postretirement plan within the scope of the standard.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy as defined in the standard. Additionally, companies are required to provide enhanced disclosure regarding financial instruments in one of the categories, including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. In November 2007, the FASB authorized its staff to draft a proposed FASB Staff Position ("Proposed FSP") that would partially defer the effective date of SFAS No. 157 for one year for non-financial assets and liabilities that are recognized or disclosed at fair

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value in the financial statements on a non-recurring basis. If the proposed FSP is approved, SFAS No. 157 will be effective for financial statements issued for fiscal years beginning after November 15, 2007, or our fiscal year beginning September 1, 2008, for financial assets and liabilities carried at fair value on a recurring basis and on September 1, 2009, for non-recurring non-financial assets and liabilities that are recognized or disclosed at fair value. We do not expect the adoption of SFAS No. 157 will have a material impact on our financial statements.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets to simplify accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. Additionally, SFAS No. 156 applies to all separately recognized servicing assets and liabilities acquired or issued after the beginning of an entity's fiscal year that begins after September 15, 2006, although early adoption is permitted. We adopted SFAS No. 156 on September 1, 2007, with no material impact on our financial statements.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Instruments, which amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host)

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if the holder elects to account for the whole instrument on a fair value basis. SFAS No. 155 also clarifies and amends certain other provisions of SFAS No. 133 and SFAS No. 140. This statement is effective for all financial instruments acquired or issued in financial years beginning after September 15, 2006. We adopted SFAS No. 156 on September 1, 2007, with no material impact on our financial statements.

On December 21, 2006, the FASB issued FASB Staff Position ("FSP") Emerging Issues Task Force ("EITF") 00-19-2, Accounting for Registration Payment Arrangements, which requires an issuer to account for a contingent obligation to transfer consideration under a registration payment arrangement in accordance with FASB Statement No. 5, Accounting for Contingencies and FASB Interpretation 14, Reasonable Estimation of the Amount of Loss. Registration payment arrangements are frequently entered into in connection with issuance of unregistered financial instruments, such as equity shares or warrants. A registration payment arrangement contingently obligates the issuer to make future payments or otherwise transfer consideration to another party if the issuer fails to file a registration statement with the SEC for the resale of specified financial instruments or fails to have the registration statement declared effective within a specific period. The FSP requires issuers to make certain disclosures for each registration payment arrangement or group of similar arrangements. The FSP is effective immediately for registration payment arrangements and financial instruments entered into or modified after the FSP's issuance date. For previously issued registration payment arrangements and financial instruments subject to those arrangements, the FSP is effective for financial statements issued for fiscal years beginning after December 15, 2006. We adopted this standard on September 1, 2007, with no material impact on our financial statements.

EITF No. 07-3, Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities, was issued in June 2007. The EITF reached a consensus that nonrefundable payments

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for goods and services that will be used or rendered for future research and development activities should be deferred and capitalized. Such amounts should be recognized as an expense as the related goods are delivered and the related services are performed. Entities should continue to evaluate whether they expect the goods to be delivered or services to be rendered. If the entity does not expect the goods to be delivered or services to be rendered, the capitalized advance payment should be charged to expense. This pronouncement is effective for financial statements issued for fiscal years beginning after December 15, 2007, our fiscal year beginning September 1, 2008, and interim periods within those fiscal years. Earlier application is not permitted. Entities are required to report the effects of applying this pronouncement prospectively for new contracts entered into on or after the effective date of this pronouncement. The future application of this pronouncement may have a material effect on the Company's financial condition and results of operations. We currently are unable to determine what impact the future application of this pronouncement may have on our financial statements.

Note 3. Net Income (Loss) Per Common Share

The computation of basic earnings per common share is based on the weighted average number of shares outstanding during the period. The computation of diluted earnings per common share is based on the weighted average number of shares outstanding during the period plus the weighted average common stock equivalents which would arise from the exercise of stock options outstanding using the treasury stock method and the average market price per share during the period. When common stock equivalents are anti-dilutive, they are not included. During the three months ended November 30, 2007 and November 30, 2006, 1,086,918 and 1,174,999 common stock equivalents related to stock options were not included in the computation due to their anti-dilutive effect, respectively, because of the Company's net loss.

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

| | Three Months Ended November 30, | |
|--|------------------------------------|------------|
| | 2007 | 2006 |
| Weighted average number of shares outstanding - basic | 21,311,000 | 21,036,000 |
| Dilutive effect of stock options | - | - |
| Weighted average number of shares outstanding - diluted | 21,311,000 | 21,036,000 |

Note 4. Inventories

Inventories consist of the following:

| | November 30, 2007 | August 31, 2007 |
|--|----------------------|--------------------|
|--|----------------------|--------------------|

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| | | |
|--------------------------------|--------------|--------------|
| | ----- | |
| Parts and supplies | \$ 869,778 | \$ 835,498 |
| Work-in-process | 718,919 | 610,846 |
| Finished goods | 53,806 | 103,723 |
| Reserve for obsolete inventory | (40,000) | (40,000) |
| | ----- | |
| Inventories, net | \$ 1,602,503 | \$ 1,510,067 |
| | ===== | |

Note 5. Property and Equipment

Property and equipment consist of the following:

| | | |
|-------------------------------|----------------------|--------------------|
| | November 30, 2007 | August 31, 2007 |
| | ----- | |
| Equipment | \$ 968,054 | \$ 962,162 |
| Furniture and fixtures | 298,576 | 298,576 |
| Leasehold improvements | 17,420 | 17,420 |
| Building | 956,000 | - |
| Land | 244,000 | - |
| | ----- | |
| | 2,484,050 | 1,278,158 |
| Less accumulated depreciation | (1,032,984) | (1,007,081) |
| | ----- | |
| Property and equipment, net | \$ 1,451,066 | \$ 271,077 |
| | ===== | |

When the lease on the Company's office, production and research facilities expired in November 2007, the Company exercised its option to purchase the building and land for a total purchase price of \$1,200,000.

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Note 6. Related Party Transactions

During the three months ended November 30, 2007 and November 30, 2006, we had sales of \$908,025 and \$16,044, respectively, to an entity controlled by a significant stockholder and member of the Board of Directors. These related party transactions represent approximately 65% and 2% of total sales for each respective three-month period.

At November 30, 2007 and August 31, 2007, receivables included \$1,036,247 and \$488,200, respectively, from this entity.

Note 7. Stock-Based Compensation

We have a stock-based employee plan and a director option plan which are described more fully in Note 11 in our 2007 Annual Report on Form 10-K. As of November 30, 2007, we had approximately 502,000 shares of common stock reserved for future issuance under the stock option plans.

The Company accounts for stock-based compensation in accordance with

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SFAS No. 123(R), Share Based Payments. Under the fair value recognition provisions of this statement, 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. The stock-based compensation expense for the three-month period ended November 30, 2007 has been allocated to the various categories of operating costs and expenses in a manner similar to the allocation of payroll expense as follows:

| | | |
|-------------------------------------|--------|-------------|
| Cost of sales | \$ | 21,148 |
| Research and development | | 25,495 |
| Selling, general and administrative | | 111,987 |
| | | ----- |
| Total | \$ | 158,630 |
| | | ===== |

Stock-based compensation expense for the three-month period ended November 30, 2006 of \$234,210 has been included in selling, general and administrative expenses.

During the three months ended November 30, 2007, we granted 120,000 options to our directors, with one fifth vesting each year for the next five years, and 10,000 options to employees, with one third vesting each year for the next three years. This grant accounts for \$25,492 of the total stock-based compensation expense for the three months ended November 30, 2007.

Unrecognized stock-based compensation expense expected to be recognized over the estimated weighted-average amortization period of 1.89 years is approximately \$1,912,000 at November 30, 2007.

Our weighted-average assumptions used in the Black-Scholes valuation model for equity awards with time-based vesting provisions granted during the three months ended November 30, 2007 are shown below:

| | | |
|-------------------------|--|------------|
| Expected volatility | | 63.38% |
| Expected dividends | | 0% |
| Expected term | | 6.25 Years |
| Risk-free interest rate | | 4.28% |

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

A summary of the time-based stock option awards as of November 30, 2007, and changes during the three months then ended, is as follows:

| Weighted- Average Exercise | Weighted- Average Remaining Contract Term | Aggregate Intrinsic |
|----------------------------------|--|------------------------|
|----------------------------------|--|------------------------|

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| | Shares | Price | (Years) | Value |
|----------------------------------|-----------|---------|---------|--------------|
| | | | | |
| Outstanding at August 31, 2007 | 1,795,853 | \$ 2.31 | | |
| Granted | 130,000 | 6.46 | | |
| Exercised | (11,000) | 1.34 | | |
| Forfeited or expired | - | - | | |
| | | | | |
| Outstanding at November 30, 2007 | 1,914,853 | \$ 2.60 | 6.71 | |
| | | | | |
| Exercisable at November 30, 2007 | 1,339,712 | \$ 1.58 | 5.77 | \$ 5,253,977 |
| | | | | |

The weighted-average grant-date fair value of stock options granted during the three months ended November 30, 2007 was \$4.05.

Note 8. Supplemental Cash Flow Information

The Company paid no amounts for interest during the three months ended November 30, 2007 and 2006. The Company paid no amounts for income taxes during the three months ended November 30, 2007, and paid \$1,500,000 for income taxes during the three months ended November 30, 2006.

During the three months ended November 30, 2007, the Company had the following non-cash financing and investing activities:

- o Recorded an increase in additional paid-in capital of \$115,027, a decrease in long-term deferred tax asset of \$76,000 and an increase in income tax receivable of \$191,027 related to the tax benefit from the exercise of stock options.
- o Increased other comprehensive loss by \$368,600, decreased investments by \$156,600 and decreased short-term deferred tax asset by \$212,000.
- o Increased common stock and decreased additional paid-in capital by \$1.

During the three months ended November 30, 2006, the Company had the following non-cash financing and investing activities:

- o Increased other comprehensive income and increased investments by \$30,869.

- o Transferred deferred compensation of \$247,000 to additional paid-in capital.
- o Decreased income taxes payable and decreased income tax receivable by \$39,946.

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.

General

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

While our primary developments to date have been cancer treatment systems, we also pioneered the use of microwave thermal therapy for the treatment of symptoms associated with enlarged prostate, and we are responsible for much of the technology that created a new medical industry using that therapy. In accordance with our strategic plan, we subsequently sold our interest in TherMatrx, Inc., the company established to commercialize our technology for treating enlarged prostate symptoms, to provide funding that we can utilize for commercializing our systems used in the treatment of cancer and in pursuing other business objectives.

In spite of the advances in cancer treatment technology, according to the American Cancer Society over 40% of cancer patients continue to die from the disease in the United States, and cancer has now surpassed heart disease as the number one killer from all causes of death in the United States.

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

Our BSD-2000 systems are used to non-invasively treat cancers located deeper in the body, and are designed to be companions to the estimated 7,500 linear accelerators used to treat cancer through radiation and in combination with chemotherapy treatments. Our BSD-500 systems treat cancers on or near the body surface and those that can be approached through body orifices such as the throat, the rectum, etc., or through interstitial treatment in combination with interstitial radiation (brachytherapy). BSD-500 systems can be used as companions to our BSD-2000 systems and the estimated 2,500 brachytherapy systems installed, as well as with chemotherapy treatments. The MicroThermX 100 system is used to treat cancers that can be destroyed with heat alone.

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Based on our management team's knowledge of the market, we believe that the fully saturated potential market for these developed cancer therapy systems is in excess of \$5 billion. We also project an after-market opportunity based on service agreements that equates to approximately 15% of the purchase price of our systems per year. We believe that the replacement cycle for our systems, based on advances in software, hardware and other components, will average 5-7 years. We estimate our financial model in the higher production environment of established commercial sales could achieve a 60% gross margin on systems and an 80% gross margin on service agreements and disposable applicators used with our MicroThermX 100 system, although there is no assurance that these results will be obtained.

We have received United States Food and Drug Administration, or FDA, approval to market our commercial version of the BSD-500, and in March 2006, we completed a submission for FDA approval to sell the BSD-2000 in the United States. In August 2007, we successfully concluded a pre-approval and quality system inspection by the FDA. On December 31, 2007, we received a letter from the FDA providing guidance regarding amendments needed to make the BSD-2000 submission approvable. We are currently preparing our FDA submission for the MicroThermX 100 system. We have designed our cancer therapy systems such that together they are capable of providing treatment for most solid tumors located virtually anywhere in the body.

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

Critical Accounting Policies and Estimates

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

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

Revenue from manufacturing services is recorded when an agreement with the customer exists for such services, the services have been provided, and collection is reasonably assured. Revenue from training services is recorded when an agreement with the customer exists for such training, the training services have been provided, and collection is reasonably assured. Revenue from service support contracts is recognized on a straight-line basis over the term of the contract.

Our revenue recognition policy is the same for sales to both related parties and non-related parties. We provide the same products and services under the same terms to non-related parties as to 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 periodically review our inventory levels and usage, paying particular attention to slower-moving items. If projected sales

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for fiscal 2008 do not materialize or if our hyperthermia systems do not receive increased market acceptance, we may be required to increase the reserve for inventory impairment in future periods.

Product Warranty. We provide product warranties on our BSD-500 and BSD-2000 systems. These warranties vary from contract to contract, but generally consist of parts and labor warranties for one year from the date of installation. To date, expenses resulting from such warranties have not been material. We record a warranty expense at the time of each sale. This reserve is estimated based on prior history of service expense associated with similar units sold in the past.

Allowance for Doubtful Accounts. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. As of November 30, 2007 and August 31, 2007 we had a \$20,000 balance in this account. 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

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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 - We account for stock-based compensation in accordance with SFAS No. 123(R), which requires us to measure the compensation cost of stock options and other stock-based awards to employees and directors at fair value at the grant date and recognize compensation expense over the requisite service period for awards expected to vest. During the three months ended November 30, 2007 and November 30, 2006, we recorded compensation expense of \$158,630 and \$234,210, respectively, for stock options issued to directors and employees. The fair value of stock options is computed using the Black-Scholes valuation model, which model utilizes inputs that are subject to change over time, including the volatility of the market price of our common stock, risk free interest rates, requisite service periods and assumptions made by us regarding the assumed life and vesting of stock options and stock-based awards. As new options or stock-based awards are granted, additional non-cash compensation expense will be recorded by us.

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 within two years to offset income taxes previously paid, we record an income tax receivable and a current income tax benefit.

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Results of Operations

Three Months Ended November 30, 2007 Compared to the Three Months Ended November 30, 2006

Revenues. Total revenues for the three months ended November 30, 2007 were \$1,387,728, compared to \$664,655, for the three months ended November 30, 2006, an increase of \$723,073, or approximately 109%. The increase in total revenues was due to an increase in the volume of sales to related parties, as further discussed below. Our revenues can fluctuate significantly from period to period because our sales, to date, have been based upon a relatively small number of systems, the sales price of each being substantial enough to greatly impact revenue levels in the periods in which they occur. Sales of a few systems can cause a large change in our revenue from period to period.

Related Party Sales. We had \$908,025, or approximately 65%, of our

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revenues in the three months ended November 30, 2007 from sales to related parties as compared to \$16,044 or approximately 2%, in the three months ended November 30, 2006. These sales for the three months ended November 30, 2007 were to Medizin-Technik GmbH and consisted of product sales of \$879,512, probes of \$8,700 and other revenues of \$19,813. All of the related party revenues in the three months ended November 30, 2006 were from sales of component parts. Dr. Gerhard Sennewald, one of our stockholders and directors, is also a stockholder, executive officer and director of Medizin-Technik. Sales to Medizin-Technik may fluctuate significantly from period to period because our sales, to date, have been based upon a relatively small number of systems, the sales price of each being substantial enough to greatly impact revenue levels in the periods in which they occur. Sales of a few systems can cause a large change in our revenue from period to period.

Non-Related Party Sales. In the three months ended November 30, 2007, we had \$479,703 or approximately 35% of our revenues from sales to unrelated parties, as compared to \$648,611, or approximately 98%, for the three months ended November 30, 2006. These sales for the three months ended November 30, 2007 consisted of product sales of \$435,000, service contracts of \$15,371, probes of \$13,847 and other revenues of \$15,485. By comparison, non-related party sales for the three months ended November 30, 2006 consisted of product sales of \$586,612, consulting services of \$31,143, service contracts of \$14,110, and probes of \$16,746.

Gross Profit. Gross profit for the three months ended November 30, 2007 was \$946,873 or 68% of total product sales as compared to \$215,400 or 32%, of total product sales for the three months ended November 30, 2006. As sales volumes increase, we will more fully absorb our fixed overhead costs, thus increasing our gross profit percentage. The gross margin percentage will also fluctuate from period to period depending on the mix of revenues reported for the period.

Research and Development Expenses. Research and development expenses were \$337,353 for the three months ended November 30, 2007, as compared to \$332,079, for the three months ended November 30, 2006, an increase of \$5,274, or approximately 2%.

Selling General and Administrative Expenses. Selling, general and administrative expenses decreased to \$1,393,947 in the three months ended November 30, 2007, from \$1,556,441 for the three months ended November 30, 2006, a decrease of \$162,494 or approximately 10%. This decrease was primarily due to a reduction in compensation expense related to the issuance of stock options charged to selling, general and administrative expenses in the current year. We anticipate that our selling, general and administrative expenses will continue at the level reported in the first quarter of the current fiscal year or increase, at least in the short term.

Interest Income. Interest income decreased to \$189,348 for the three months ended November 30, 2007 as compared to \$370,213 for the three months ended November 30, 2006, due to lower levels of cash and investments in the

current fiscal year and due to a lower rate of return recognized on investments in the current fiscal year.

Income Tax Benefit. For the three months ended November 30, 2007, we reported an income tax benefit of \$43,000, which was comprised of a current income tax benefit of \$211,000, partially offset by a deferred income tax provision of \$168,000. The current income tax benefit of \$211,000 represents an

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increase to our income tax receivable resulting from our ability to carry-back our taxable loss in the current period to offset income taxes previously paid. The deferred income tax provision of \$168,000 resulted primarily from our recording a 100% valuation allowance against our deferred tax assets as of November 30, 2007. In recording the valuation allowance, we were unable to conclude that it is more likely than not that our deferred tax assets will be realized. In reaching this determination, we evaluated factors such as prior earnings history, expected future earnings and our ability to carry-back reversing items within two years to offset income taxes paid.

For the three months ended November 30, 2006, we reported an income tax benefit of \$468,968, which was comprised of a current income tax benefit of \$367,968 and a deferred income tax benefit of \$101,000.

Net Loss. During the three months ended November 30, 2007, we had a net loss of \$615,935, after recording an income tax benefit of \$43,000, as compared to an after tax net loss of \$861,671 in the three months ended November 30, 2006. Our net loss in the first three months of the current fiscal year decreased \$245,736 compared to the net loss in the first three months of the prior year, primarily due to the increase in related party sales and the decrease in our total operating costs and expenses in the current year, partially offset by our recording of a deferred income tax provision of \$168,000 in the first three months of the current year, as further discussed above.

Liquidity and Capital Resources

Since inception through November 30, 2007, we have generated an accumulated deficit of \$3,466,088. We have historically financed our operations through cash from operations, research grants, licensing of technological assets, issuance of common stock and the sale of investments in spinoff operations. As of November 30, 2007, we had cash, cash equivalents and investments totaling \$16,592,124 as compared to cash, cash equivalents and investments totaling \$19,506,658 as of August 31, 2007.

During the three months ended November 30, 2007, we used \$1,543,075 of cash in operating activities, primarily as a result of our net loss of \$615,935, increase in receivables of \$835,910, increase in income tax receivable of \$211,000, increase in inventories of \$92,436, and decrease in customer deposits of \$131,573, partially offset by a decrease in deferred tax assets of \$168,000. By comparison, net cash used in operating activities was \$2,548,110 during the three months ended November 30, 2006.

Net cash provided by investing activities for the three months ended November 30, 2007 was \$1,846,048, resulting from the sale of investments of \$3,072,907, partially offset by the purchase of property and equipment of \$1,205,892 and an increase in patents of \$20,967. For the three months ended November 30, 2006, net cash provided by investing activities was \$1,642,943, resulting from the sale of investments of \$1,666,755, partially offset by the purchase of property and equipment of \$23,812.

Net cash provided by financing activities consisted of proceeds from the sale of common stock through the exercise of stock options of \$12,000 in the three months ended November 30, 2007. No cash was provided by or used in financing activities in the three months ended November 30, 2006.

We expect to incur additional expenses related to the commercial introduction of our systems, due to additional participation at trade shows, expenditures on publicity, additional travel, increased sales salaries and

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commissions and other related expenses. In addition, we anticipate that we will incur increased expenses related to seeking governmental and regulatory approvals for our products and continued expenses related to corporate governance and compliance with the Sarbanes-Oxley Act of 2002, during fiscal 2008.

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

As of November 30, 2007, we have no significant commitments for the purchase of property and equipment.

We believe that our current cash and cash equivalents, investments, and expected cash provided from operating activities will be sufficient to fund our operations for the next twelve months.

FORWARD-LOOKING STATEMENTS

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

- o our belief about the market opportunities for our products;
- o our anticipated financial performance and business plan;
- o our expectations regarding the commercialization of the BSD-2000, BSD 500 and MicroThermX 100 systems;
- o our expectations to further expand our developments to treat other diseases and medical conditions;
- o our expectations that in a higher production environment of established commercial sales we could achieve a 60% gross margin on system sales and an 80% gross margin on service agreements and disposable applicators used with our MicroThermX 100 system;
- o our belief concerning the market potential for developed cancer therapy systems;
- o our expectations related to the after-market opportunity for service agreements;
- o our expectations related to the replacement cycle for our systems;
- o our expectations that we will incur increased expenses related to seeking governmental and regulatory approvals for our products;

- o our expectations and efforts regarding FDA approvals relating to the BSD-2000 and MicroThermX 100 systems;
- o our belief that our technology has application for additional approaches to treating cancer and for other medical purposes;
- o our expectations related to the amount of expenses we will incur for the commercial introduction of our systems;
- o our expectation that we will incur increased expenses related to our corporate governance and compliance with the Sarbanes-Oxley Act of 2002;
- o our expectation that our selling, general and administrative expenses will continue at the same or increased levels at least in the short term;
- o our belief that we can cover any cash shortfall with cost cutting or available cash; and
- o our belief that our current working capital, investments and cash from operations will be sufficient to finance our operations through working capital and capital resources needs for 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 the Item entitled "Risk Factors" included in our Annual Report on Form 10-K for the year ended August 31, 2007 and our other filings with the Securities and Exchange Commission. We also wish to advise readers not to place any undue reliance on the forward-looking statements contained in this report, which reflect our beliefs and expectations only as of the date of this report. We assume no obligation to update or revise these forward-looking statements to reflect new events or circumstances or any changes in our beliefs or expectations, other than as required by law.

Item 3. Quantitative and Qualitative Disclosure About Market Risk.

A significant portion of the Company's cash equivalents and short-term investments bear variable interest rates that are adjusted to market conditions. Changes in market rates will affect interest earned and potentially the market value of the principal of these instruments. The Company does not utilize derivative instruments to offset the exposure to interest rate changes. Significant changes in interest rates may have a material impact on the Company's investment income, but not on the Company's consolidated results of operations.

The Company does have significant sales to foreign customers and is therefore subject to the effects that changes in foreign currency exchange rates may have on demand for its products and services. The Company does not utilize derivative instruments to offset the exposure to changes in foreign currency exchange rates. To minimize foreign exchange risk, the Company's export sales are transacted in United States dollars.

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Item 4. Controls and Procedures.

Evaluation of disclosure controls and procedures.

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our management including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based on this evaluation, the principal executive officer and principal financial officer concluded that 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 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 factors discussed in Item 1A - "Risk Factors" in our annual report on Form 10-K for the year ended August 31, 2007, which could materially affect our business, financial condition or future results of operations. The information presented below updates these risk factors and should be read in conjunction with the risk factors and information disclosed in that Form 10-K. The risks discussed in our annual report on Form 10-K, as updated in this report, are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or results of operations.

We have not yet received pre-market approval for our BSD-2000 and MicroThermx 100 systems, which is necessary for us to commercially market these systems in the U.S.

We have not yet received pre-market approval for our BSD-2000 and MicroThermx 100 systems. Obtaining these pre-market approvals from the FDA is necessary for us to commercially market these systems in the United States. Obtaining approvals is a lengthy and expensive process. On December 31, 2007, we received a letter from the FDA providing guidance regarding amendments needed to make the BSD-2000 submission approvable. We may not be able to obtain these approvals on a timely basis, if at all, and such failure could harm our business prospects substantially. Further, even if we are able to obtain the approvals we seek from the FDA, the approvals granted might include significant limitations on the indicated uses for which the products may be marketed, which restrictions could negatively impact our business.

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Item 6. Exhibits.

The following exhibits are filed as part of this report:

| Exhibit No. | Description of Exhibit |
|-------------|---|
| 3.2 | Bylaws of BSD Medical Corporation, as amended |
| 31.1 | Certification of Principal Executive Officer Required Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Principal Financial 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 Financial Officer Required Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

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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: | January 9, 2008 | /s/ Hyrum A. Mead |
| | | ----- |
| | | Hyrum A. Mead |
| | | President (Principal Executive Officer) |
| Date: | January 9, 2008 | /s/ Dennis P. Gauger |
| | | ----- |
| | | Dennis P. Gauger |
| | | Chief Financial Officer (Principal Accounting Officer) |

