BSD MEDICAL CORP
Form 10-Q
July 16, 2007

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended May 31, 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	75-1590407
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes |X| 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 |X|

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

As of July 16, 2007, there were 21,284,353 shares of the registrant's common stock, $0.001 par value per share, outstanding.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

BSD MEDICAL CORPORATION
Condensed Balance Sheets
(Unaudited)

Assets	May 31, 2007	August 31, 2006
Current assets:		
Cash and cash equivalents	$ 1,139,397	$ 2,179,094
Investments	19,633,218	22,556,106
Receivables, net	748,649	1,186,800
Related party trade receivables	565,964	261,543
Income tax receivable	1,075,667	-
Inventories, net	1,285,688	1,366,264
Deferred tax asset	359,000	178,000
Other current assets	224,755	120,277
Total current assets	25,032,338	27,848,084
Property and equipment, net	294,760	303,034
Note receivable	-	137,500
Patents, net	19,842	21,250
	$ 25,346,940	$ 28,309,868

Liabilities and Stockholders' Equity	May 31, 2007	August 31, 2006
Current Liabilities:		
Accounts payable	$ 331,608	$ 365,396
Accrued liabilities	443,497	545,113
Income taxes payable	-	1,539,946
Deferred revenue - current portion	28,838	17,912
Total current liabilities	803,943	2,468,367
Deferred revenue - less current portion	53,333	217,500
Total liabilities	857,276	2,685,867
Commitments and contingencies		
Stockholders' equity:		

Preferred stock, $.001 par value; 10,000,000 authorized, no shares issued and outstanding	-	-
Common stock, $.001 par value; 40,000,000 shares authorized; 21,279,353 and 21,023,668 shares issued and outstanding	21,280	21,024
Additional paid-in capital	26,155,108	25,452,231
Deferred compensation	-	(247,700)
Treasury stock , 24,331 shares at cost	(234)	(234)
Other comprehensive income (loss)	24,562	(99,362)
Retained earnings (deficit)	(1,711,052)	498,042
Total stockholders' equity	24,489,664	25,624,001
	$ 25,346,940	$ 28,309,868

See accompanying notes to condensed financial statements.

BSD MEDICAL CORPORATION
Condensed Statements of Operations
(Unaudited)

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2007	2006	2007	200
Sales	$ 432,123	$ 264,050	$ 1,258,808	$ 1,004
Related party sales	521,053	448,721	1,019,680	669
Total sales	953,176	712,771	2,278,488	1,673
Costs and expenses:				
Cost of sales	200,620	167,464	703,006	680
Cost of related party sales	279,911	245,250	650,097	393
Research and development	451,721	380,623	1,292,578	945
Selling, general, and administrative	1,400,170	1,329,282	4,287,870	3,553
Total costs and expenses	2,332,422	2,122,619	6,933,551	5,572
Operating loss	(1,379,246)	(1,409,848)	(4,655,063)	(3,899
Other income				

Interest income	331,579	411,777	1,044,249	960
Other income (expense)	180,384	5,935,315	106,048	17,750
Total other income	511,963	6,347,092	1,150,297	18,711
Income (loss) before income taxes	(867,283)	4,937,244	(3,504,766)	14,812
Income tax (provision) benefit	232,645	(1,949,621)	1,295,672	(5,506
Net income (loss)	$ (634,638)	$ 2,987,623	$ (2,209,094)	$ 9,305
Net income (loss) per common share:				
Basic	$ (0.03)	$ 0.14	$ (0.10)	$
Diluted	$ (0.03)	$ 0.13	$ (0.10)	$
Weighted average number of shares outstanding:				
Basic	21,135,000	20,926,000	21,071,000	20,683
Diluted	21,135,000	22,163,000	21,071,000	22,148

See accompanying notes to condensed financial statements.

BSD MEDICAL CORPORATION
Condensed Statements of Cash Flows
(Unaudited)

	Nine Months Ended May 31,	
	2007	2006
Cash flows from operating activities:		
Net income (loss)	$ (2,209,094)	$ 9,305,545
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Provision for doubtful accounts	83,700	-
Depreciation and amortization	70,111	64,195
Loss on disposition of property and equipment	2,577	-
Stock compensation expense	673,678	48,471
Amortization of deferred compensation	-	75,950
Gain on sale of investment in TherMatrx	(202,223)	(17,413,342)
(Increase) decrease in:		
Receivables	491,951	(335,760)
Related party receivables	(304,421)	(105,745)
Income tax refund receivable	(1,068,164)	-
Inventories	80,576	(383,857)
Deferred tax asset	(181,000)	(111,000)
Other current assets	(104,478)	(1,028)
Increase (decrease) in:		
Accounts payable	(33,788)	411,138

Accrued expenses	(101,616)	221,055
Income taxes payable	(1,500,000)	4,998,125
Deferred revenue	(153,241)	10,219
Deferred tax liability	-	(13,000)
Net cash used in operating activities	(4,455,432)	(3,229,031)
Cash flows from investing activities:		
Proceeds from sale of investment in TherMatrx	202,223	17,413,342
(Purchase) sale of investments	3,046,812	(14,770,709)
Purchase of property and equipment	(63,006)	(194,866)
Net cash provided by investing activities	3,186,029	2,447,767
Cash flows from by financing activities:		
Proceeds from sale of common stock	229,706	415,036
Decrease in cash and cash equivalents	(1,039,697)	(366,228)
Cash and cash equivalents, beginning of period	2,179,094	908,674
Cash and cash equivalents, end of period	$ 1,139,397	$ 542,446

Supplemental Disclosure of Cash Flow Information

- The Company paid no cash for interest during the nine months ended May 31, 2007 and 2006 and $1,798,676 and $392,311 for income taxes during the nine months ended May 31, 2007 and 2006, respectively.

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- The Company issued 349,368 stock options during the nine months ended May 31, 2006, which resulted in an increase to deferred compensation of $363,200.

- The Company had an income tax benefit from the exercise of stock options of $47,449 and $972,282 during the nine months ended May 31, 2007 and 2006, respectively, which was recorded as an increase to additional paid-in capital and a reduction in income taxes payable.

- The Company had an unrealized gain of $123,924 during the nine months ended May 31, 2007 on available-for-sale securities. The Company had an unrealized loss of $115,305 during the nine months ended May 31, 2006 on available-for-sale securities.

- The Company transferred deferred compensation of $247,700 to additional paid-in capital during the nine months ended May 31, 2007.

- The Company decreased income taxes payable and decreased income tax receivable by $39,946 during the nine months ended May 31, 2007.

- The Company increased common stock and decreased additional paid-in capital by $50 during the nine months ended May 31, 2007.

See accompanying notes to condensed financial statements

BSD MEDICAL CORPORATION
Notes to Condensed Financial Statements

Note 1. Basis of Presentation

The accompanying unaudited condensed balance sheets of BSD Medical Corporation (the "Company") as of May 31, 2007 and August 31, 2006 and the related unaudited condensed statements of operations and of cash flows for the three months and nine months ended May 31, 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 (SEC). The condensed financial statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. These condensed financial statements should be read in conjunction with the notes thereto, and the financial statements and notes thereto included in our annual report on Form 10-KSB for the year ended August 31, 2006.

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

Note 2. Recent Accounting Pronouncements

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

In 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. 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. The adoption of this statement is not expected to have a material effect on the Company's 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. The Company anticipates adopting SFAS No. 158 on August 31, 2007, and does not believe the adoption of the new accounting standard will result in a material impact on the consolidated financial statements of the Company since the Company currently does not sponsor the defined benefit pension or postretirement plans within the scope of the standard.

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

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

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Instruments, which amends SFAS No. 133, Accounting for Derivative

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

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. To the extent that we enter into financing arrangements in the future that include registration payment arrangements, the future application of this FSP may have a material effect on our financial condition and results of operations.

In June 2006, the FASB ratified EITF, No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation). EITF No. 06-3 requires that, for interim and annual reporting periods beginning after December

15, 2006, we disclose our policy related to the presentation of sales taxes and similar assessments related to our revenue transactions. Early adoption is permitted. We present revenue net of sales taxes and any similar assessments. EITF No. 06-3 had no effect on our financial position and results of operations.

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 and nine months ended May 31, 2007, 1,224,696 and 1,310,551 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.

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

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2007	2006	2007	2006
Weighted average number of shares outstanding - basic	21,135,000	20,926,000	21,071,000	20,683,000
Dilutive effect of stock options	-	1,237,000	-	1,465,000
Weighted average number of shares outstanding - diluted	21,135,000	22,163,000	21,071,000	22,148,000

Note 4. Inventories

Inventories consist of the following:

	May 31, 2007	August 31, 2006
Parts and supplies	$ 775,221	$ 711,552
Work-in-process	550,467	641,608
Finished goods	-	53,104
Reserve for obsolete inventory	(40,000)	(40,000)
Inventories, net	$ 1,285,688	$ 1,366,264

Note 5. Related Party Transactions

During the three months ended May 31, 2007 and May 31, 2006, we had sales of $521,053 and $448,721, respectively, to an entity controlled by a significant stockholder and member of the Board of Directors. These related party transactions represent 55% and 63% of total sales for each respective three-month period.

During the nine months ended May 31, 2007 and May 31, 2006, we had sales of $1,019,680 and $669,041, respectively, to this related party. These related party transactions represent 45% and 40% of total sales for each respective nine-month period.

At May 31, 2007 and August 31, 2006, receivables include $565,964 and $261,543 respectively, from this entity.

Note 6. Stock-Based Compensation

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

Our condensed financial statements as of May 31, 2007 and for the three months and nine months ended May 31, 2007 reflect the impact of the implementation of SFAS 123(R). We adopted SFAS 123(R) using the modified prospective transition method, which requires that compensation expense be recognized during the three months and nine months ended May 31, 2007 equal to: (a) amortization related to the compensation cost for all share-based payments granted prior to, but not yet vested as of September 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (b) amortization related to compensation cost for all share-based payments granted subsequent to September 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). Results for prior periods have not been restated.

We have two stock-based employee plans and a director option plan which are described more fully in Note 11 in our 2006 Annual Report on Form 10-KSB. As of May 31, 2007, we had approximately 782,000 shares of common stock reserved for future issuance under the stock option plans.

The adoption of SFAS 123(R) had a significant impact on our results of operations. Our statements of operations for the three months and nine months ended May 31, 2007 include stock-based compensation expense from stock options in selling, general and administrative expenses of $204,734 and $613,678, respectively.

During the nine months ended May 31, 2007, we granted 120,000 options to our directors, with one fifth vesting each year for the next five years. This grant accounts for $51,488 of the stock-based compensation expense for the nine months ended May 31, 2007.

Unrecognized stock-based compensation expense expected to be recognized over the estimated weighted-average amortization period of 1.39 years is approximately $1,261,000 at May 31, 2007.

Our weighted-average assumptions used in the Black-Scholes valuation model for equity awards with time-based vesting provisions granted during the nine months ended May 31, 2007 are shown below:

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

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

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The following table illustrates the effect on net income and income per share if we had applied the fair value recognition provisions of Statement 123 to options granted under our stock option plans and the employee stock purchase plan for the three months and nine months ended May 31, 2006. For purposes of this pro-forma disclosure, the value of the options is estimated using a Black-Scholes option-pricing model and charged to expense over the options' vesting periods.

	Three Months Ended May 31, 2006	Nine Months Ended May 31, 2006
Net income - as reported	$ 2,987,623	$ 9,305,545
Add: Stock-based employee compensation expense included in reported net income, net of related taxes tax effects	-	75,950
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of related taxes	(6,377)	(177,175)
Net income - pro forma	$ 2,981,246	$ 9,204,320
Income per common share - as reported:		
Basic	$ .14	$ .45
Diluted	$ .13	$ .42
Income per common share - pro forma:		
Basic	$ .14	$ .44
Diluted	$ .13	$ .42

A summary of the time-based stock option awards as of May 31, 2007, and changes during the nine months then ended, is as follows:

Stock Option Awards	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contract Term (Years)	Aggregate Intrinsic Value
Outstanding at August 31, 2006	1,809,051	$ 1.72		
Granted	120,000	4.77		
Exercised	(256,247)	1.18		
Forfeited or expired	-	-		
Outstanding at May 31, 2007	1,672,804	$ 2.03		
Exercisable at May 31, 2007	1,308,022	$ 1.39	6.11	$ 8,578,399

The weighted-average grant-date fair value of stock options granted during the nine months ended May 31, 2007 was $2.87.

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

Note 7. TherMatrx Sales Proceeds

In April 2007, we received an additional $202,223 in proceeds from the sale of TherMatrx, Inc. We previously reported that we had received the last of the contingency payments from the sale. However, pursuant to the performance of certain audit procedures requested by the former management of TherMatrx, additional contingency payments were calculated and distributed.

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 consolidated financial statements and notes thereto included in this report. We assume no obligation to revise or update any forward-looking statements for any reason, except as required by law.

General

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

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

In spite of the advances in cancer treatment technology, 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. 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.

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

We have received United States Food and Drug Administration, or FDA, approval to market our commercial version of the BSD-500, and in March 2006, we completed a submission for FDA approval to sell the BSD-2000 in the United States. We 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.

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. As of May 31, 2007, we had recorded a reserve for potential inventory impairment of $40,000. We periodically review our inventory levels and usage, paying particular attention to slower-moving items. If projected sales for fiscal 2007 do not materialize or if our hyperthermia systems do not receive increased market acceptance, we may be required to increase the reserve for inventory 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 August 31, 2006 we had a $20,000 balance in this account. During the nine months ended May 31, 2007, we analyzed our outstanding accounts receivables and determined that we should increase our allowance for doubtful accounts by $83,700 to a balance of $103,700 at May 31, 2007. This allowance is a significant estimate and is regularly evaluated by us for adequacy by taking into consideration factors such as past experience, credit quality of the customer base, age of the receivable balances, both individually and in the aggregate, and current economic conditions that may affect a customer's ability to pay. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Stock-based Compensation - On September 1, 2006 we adopted SFAS No. 123(R), which requires us to measure the compensation cost of stock options and other stock-based awards to employees and directors at fair value at the grant date and recognize compensation expense over the requisite service period for awards expected to vest. During the three months and nine months ended May 31, 2007, we recorded compensation expense of $204,734 and $613,678, 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. Upon adoption of SFAS No. 123 (R) on September 1, 2006, we reclassified the balance of deferred compensation of $247,700 to additional paid-in capital.

Results of Operations

Three Months Ended May 31, 2007 Compared to the Three Months Ended May 31, 2006

Revenues. Total revenues for the three months ended May 31, 2007 were $953,176, compared to $712,771, for the three months ended May 31, 2006, an increase of $240,405, or approximately 34%. The increase in total revenues was due to an increase in the volume of sales to both unrelated and 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 earned $521,053, or approximately 55%, of our revenues in the three months ended May 31, 2007 from sales to related parties as compared to $448,721 or 63%, in the three months ended May 31, 2006. These sales for the three months ended May 31, 2007 were to Medizin-Technik GmbH and consisted of product sales of $468,875, probes of $8,700 and other revenues of $43,478. All of the related party revenues in the three months ended May 31, 2006 was from sales of systems and component parts. Dr. Gerhard Sennewald, one of our directors, is a stockholder, executive officer and a 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.

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Non-Related Party Sales. In the three months ended May 31, 2007, we earned $432,123 or 45%, of our revenues from sales to unrelated parties, as compared to $264,050, or 37%, for the three months ended May 31, 2006. These sales for the three months ended May 31, 2007 consisted of product sales of $410,000, service contracts of $12,763, probes of $3,300 and other revenues of $6,060. By comparison, these sales for the three months ended May 31, 2006 consisted of product sales of $192,334, consulting services of $46,896, service contracts of $16,161, probes of $2,748 and other revenues of $5,911.

Gross Profit. Gross profit for the three months ended May 31, 2007 was $472,645 or 50% of total product sales as compared to $300,057 or 42%, of total product sales for the three months ended May 31, 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.

Selling General and Administrative Expenses. Selling, general and administrative expenses increased to $1,400,170 in the three months ended May 31, 2007, from $1,329,282 for the three months ended May 31, 2006, an increase of $70,888 or approximately 5%. This increase was primarily due to $204,734 in compensation expense related to issuance of stock options. We anticipate that our selling, general and administrative expenses will continue at this increased level at least in the short term.

Research and Development Expenses. Research and development expenses were $451,721 for the three months ended May 31, 2007, as compared to $380,623, for the corresponding period of fiscal 2006, an increase of $71,098, or approximately 19%. Research and development expenses in the three months ended May 31, 2007 increased due to expanded activities related to the following:

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

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

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

- Development of new microwave ablation disposable applicators.

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

Interest Income. Interest income decreased to $331,579 for the three months ended May 31, 2007 as compared to $411,777 for the three months ended May 31, 2006, due to lower levels of cash and investments in the current fiscal year.

Net Income (Loss). During the three months ended May 31, 2007 we had a net loss of $634,638 after recording a tax benefit of $232,645 as compared to an after tax net income of $2,987,623 in the corresponding period of 2006. The net income in the previous fiscal year was attributed primarily to the gain on sale of our investment in TherMatrx.

Nine Months Ended May, 2007 Compared to the Nine Months Ended May 31, 2006

Revenues. Total revenues for the nine months ended May 31, 2007 were $2,278,488, compared to $1,673,313, for the nine months ended May 31, 2006, an increase of $605,175, or approximately 36%. The increase in total revenues was due to an increase in the volume of sales to both unrelated and 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 earned $1,019,680, or approximately 45%, of our revenues in the nine months ended May 31, 2007 from sales to related parties as compared to $669,041 or 40%, in the nine months ended May 31, 2006. These sales for the nine months ended May 31, 2007 were to Medizin-Technik and consisted of product sales of $837,750, probes of $34,080 and other revenues of $147,850. All of the related party revenues in the nine months ended May 31, 2006 was from sales of systems and component parts.. 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 nine months ended May 31, 2007, we earned $1,258,808 or 45%, of our revenues from sales to unrelated parties, as compared to $1,004,272, or 60%, for the nine months ended May 31, 2006. These sales for the nine months ended May 31, 2007 consisted of product sales of $1,172,887, consulting services of $36,309, service contracts of $33,616, probes of $3,300 and other revenue of $12,696. By comparison, these sales for the nine months ended May 31, 2006 consisted of product sales of $886,954, consulting services of $89,268, and service contracts of $28,050.

Gross Profit. Gross profit for the nine months ended May 31, 2007 was $925,385 or 40% of total product sales, as compared to $599,369 or 36% of total product sales for the nine months ended May 31, 2006. As sales volume increases, 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.

Selling General and Administrative Expenses. Selling, general and administrative expenses increased to $4,287,870 in the nine months ended May 31, 2007, from $3,553,103 for the nine months ended May 31, 2006, an increase of $734,767 or approximately 21%. This increase was primarily due to an increase in sales and marketing costs supporting new product sales and market development activities and $613,678 in compensation expense related to issuance of stock options. We anticipate that our selling, general and administrative expenses will continue at this increased level at least in the short term.

Research and Development Expenses. Research and development expenses were $1,292,578, for the nine months ended May 31, 2007, as compared to $945,527, for the corresponding period of fiscal 2006, an increase of $347,051, or approximately 37%. Research and development expenses in the nine months ended May 31, 2007 increased due to expanded activities related to the following:

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

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

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

- Development of new microwave ablation disposable applicators.

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

Interest Income. Interest income increased to $1,044,249 for the nine months ended May 31, 2007, as compared to $960,990 for the nine months ended May 31, 2006, due to higher average levels of cash and investments and higher rates in the current fiscal year.

Net Income (Loss). During the nine months ended May 31, 2007 we had a net loss of $2,209,094 after recording a tax benefit of $1,295,672 as compared to an after tax net income of $9,305,545 in the corresponding period of 2006. The net income in the previous fiscal year was attributed primarily to the gain on sale of our investment in TherMatrx.

Liquidity and Capital Resources

Since inception through May 31, 2007, we have generated an accumulated deficit of $1,711,052. We have historically financed our operations through cash from operations, research grants, licensing of technological assets, issuance of common stock and sale of investments in spinoff operations. As of May 31, 2007, we had cash, cash equivalents and investments totaling $20,772,615 as compared to cash, cash equivalents and investments totaling $24,735,200 as of August 31, 2006.

During the nine months ended May 31, 2007, we used $4,455,432 of cash in operating activities, primarily as a result of our net loss of $2,209,094, decrease in income tax payable of $1,500,000, increase in income tax receivable of $1,068,164, and deferred tax asset of $181,000, offset by decreases in receivables of $491,951 and in inventories of $80,576. Cash provided from investing activities resulted from the sale of investments of $3,046,812, additional proceeds from the sale of our investment in TherMatrx of $202,223, partially offset by the purchase of property and equipment of $63,006. Cash provided by financing activities consisted of proceeds from exercise of stock options of $229,706.

We expect to incur additional expenses related to the commercial introduction of our systems, due to additional participation at trade shows, expenditures on publicity, additional travel, increased sales salaries and commissions and other related expenses. In addition, we anticipate that we will incur increased expenses related to seeking governmental and regulatory approvals for our products and corporate governance and compliance with the Sarbanes-Oxley Act of 2002, during fiscal 2007.

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 May 31, 2007, we have no significant commitments for the purchase of property and equipment.

The Company has no off balance sheet arrangements as of May 31, 2007.

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:

- our belief about the market opportunities for our products;
- our anticipated financial performance and business plan;
- our expectations regarding the commercialization of the BSD-2000, BSD 500 and MicroThermX 100 systems;
- our expectations to further expand our developments to treat other diseases and medical conditions;
- our expectations that in a higher production environment of established commercial sales we could achieve a 60% gross margin on system sales and an 80% gross margin on service agreements and disposable applicators used with our MicroThermX 100 system;
- our belief concerning the market potential for developed cancer therapy systems;
- our expectations related to the after-market opportunity for service agreements;
- our expectations related to the replacement cycle for our systems;
- our expectations that we will incur increased expenses related to seeking governmental and regulatory approvals for our products;
- our expectations and efforts regarding FDA approvals relating to the BSD-2000 and MicroThermX 100 systems;
- our belief that our technology has application for additional approaches to treating cancer and for other medical purposes;
- our expectations related to the amount of expenses we will incur for the commercial introduction of the BSD-2000 and MicroThermX 100 systems;
- our expectation that we will incur increased expenses related to our corporate governance and compliance with the Sarbanes-Oxley Act of 2002;

- our expectation that our selling, general and administrative expenses will continue at increased levels at least in the short term;

- our belief that we can cover any cash shortfall with cost cutting or available cash; and

- our belief that our current working capital, investments and cash from operations will be sufficient to finance our operations through working capital and capital resources needs for 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 subsection entitled "Risks Related to Our Business" included in our Annual Report on Form 10-KSB for the year ended August 31, 2006 and our other filings with the Securities and Exchange Commission. We also wish to advise readers not to place any undue reliance on the forward-looking statements contained in this report, which reflect our beliefs and expectations only as of the date of this report. We assume no obligation to update or revise these forward-looking statements to reflect new events or circumstances or any changes in our beliefs or expectations, other than as required by law.

Item 3. Quantitative and Qualitative Disclosure About Market Risk.

As of May 31, 2007, our investments consist primarily of highly-liquid mutual funds, which are considered available-for-sale securities. These investments are not held for speculative or trading purposes. Our investments may be exposed to market risk from changes in interest rates and other security market conditions that could impact our results of operations and financial position. Changes in interest rates or other market factors may materially affect the investment income we earn on cash, cash equivalents and investments.

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

Item 4. Controls and Procedures.

Evaluation of disclosure controls and procedures.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based upon that evaluation, the principal executive officer and principal financial officer concluded that for the reasons described below, as of the end of the period covered by this report, our disclosure controls and procedures were not effective and adequately designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in applicable rules and forms.

In connection with the completion of its review of our financial statements for the fiscal quarter ended November 30, 2006, Tanner LC identified deficiencies that existed in the design or operation of our internal control over financial reporting. These deficiencies included a lack of segregation of duties in our accounting department and a lack of controls over reporting and accounting for deferred income taxes, deferred compensation and stock options. These deficiencies have been disclosed to our audit committee and to our auditors. During the nine months ended May 31, 2007, we have devoted substantial efforts to fully remedy these deficiencies, including increasing the size of our financial department, and hiring of more experienced financial management with experience in accounting for deferred income taxes, deferred compensation and stock options. We are continuing our efforts to improve and strengthen our control processes and procedures. Our management, audit committee, and directors continue to work with our auditors and other outside advisors to ensure that our controls and procedures are adequate and effective.

Changes in internal controls over financial reporting.

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

PART ii - OTHER INFORMATION

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors discussed under the heading "Risks Related to Our Business" in Item 1 - Description of Business in our Annual Report on Form 10-KSB for the year ended August 31, 2006, which could materially affect our business, financial condition or future results of operations. The risks discussed in our Annual Report on Form 10-KSB are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or results of operations.

Item 6. Exhibits.

The following exhibits are filed as part of this report:

Exhibit No.	Description of Exhibit
10.1	Independent Contractor Agreement with Dennis P. Gauger dated May 1, 2007. (Incorporated by reference to Exhibit 10.1 of our Form 8-K filed May 2, 2007).
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

SIGNATURES

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

BSD MEDICAL CORPORATION

Date:	July 16, 2007	/s/ Hyrum A. Mead Hyrum A. Mead President (Principal Executive Officer)
Date:	July 16, 2007	/s/ Dennis P. Gauger Dennis P. Gauger Chief Financial Officer (Principal Accounting Officer)