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BSD MEDICAL CORP
Form 10KSB
November 29, 2006

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

FORM 10-KSB

(Mark One)

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended August 31, 2006

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-10783

BSD MEDICAL CORPORATION
(Name of Small Business Issuer 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, UT
(Address of Principal Executive Offices)

84119
(Zip Code)

(801) 972-5555
(Issuer's Telephone Number)

Securities registered pursuant to Section 12(b) of the Act:

| Title Of Each Class ----- | Name Of Each Exchange On Which Registered ----- |
|---------------------------------|--|
| Common Stock, \$0.001 par value | American Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act: None.

Check whether the issuer is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. []

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 []

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

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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]

State the issuer's revenues for its most recent fiscal year: \$2,898,402.

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of a specified date within the past 60 days. (See definition of affiliate in Rule 12b-2 of the Exchange Act.): \$58,488,953 as of November 20, 2006.

State the number of shares outstanding of each of issuers classes of common equity, as of the latest practicable date: 21,040,186 shares of common stock, par value \$0.001, as of November 20, 2006.

Documents Incorporated by Reference: None.

Transitional Small Business Disclosure Format (check one): Yes [] No [X]

2

PART I

ITEM 1. DESCRIPTION OF BUSINESS

Overview

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

In spite of the advances in cancer treatment technology, over 40% of cancer patients continue to die from the disease in the United States, and cancer has now surpassed heart disease as the number one killer from all causes of death in the United States. Commercialization of our systems used to treat cancer, including the BSD-2000 and BSD-500 families of systems and the new MicroThermX 100 microwave thermal ablation system announced this year, 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

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MicroThermX 100 system is used to treat cancers with heat alone. Current and targeted cancer treatment sites for our systems include cancers of the prostate, breast, head, neck, bladder, cervix, colon/rectum, esophagus, liver, brain, bone, stomach and lung, and including general pelvic and abdominal tumors. Our cancer treatment systems have been used to treat thousands of patients throughout the world, and have received much notoriety, including the 2005 Frost & Sullivan "Technology Innovation of the Year Award" for cancer therapy devices.

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

3

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

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

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

On June 9, 2005, our common stock began trading on the American Stock Exchange ("AMEX") under the symbol "BSM."

The Sale of TherMatrx

One of our important contributions to the advancement of medical therapy has been our pioneering work in developing a new treatment for conditions associated with enlargement of the prostate that afflicts most men as they age. As the prostate enlarges it constricts urine flow. The condition is

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known medically as benign prostatic hyperplasia or BPH. We developed a technology that allows men to be treated for BPH through an outpatient procedure as an alternative to surgery or a lengthy regimen of medication.

We determined early in our planning that we would treat our development of BPH therapy as a spin-off business with the intent of providing funding for our primary business objectives. As a result, we introduced the opportunity to investment groups and subsequently on October 31, 1997 entered into an agreement with investors Oracle Strategic Partners, L. P. and Charles Manker. Together we established a new company, TherMatrx, Inc. TherMatrx received capital from these investors to conduct clinical trials, and after obtaining FDA approval in July 2001, the funding to commercialize the development. We were compensated for providing manufacturing, regulatory and engineering support to assure the success of the new company.

4

On July 15, 2004, TherMatrx, Inc. was sold to American Medical Systems Holdings, Inc. (AMS). Our part of the total proceeds from this sale was approximately 25%. A portion of the payout from the sale was based on contingency payments. By the close of fiscal 2006, we had concluded the receipt of contingency payments from the TherMatrx sale; the payout to us, including contingency payments, being approximately \$33.5 million.

Our Contributions to Cancer Therapy

Despite the massive attention given to cancer prevention and treatment, the American Cancer Society estimates that 1,399,790 new cancer cases will be diagnosed and that 564,830 Americans will die from cancer during 2006. Now outpacing even heart disease, cancer has become the leading cause of death in the United States. Cancer develops when abnormal cells in a part of the body begin to grow out of control and spread to other parts of the body.

Our cancer treatment systems have been developed to both kill cancer directly with heat and to increase the effectiveness of the primary cancer treatment used with it. The primary cancer therapies currently used include:

- o Radiation therapy, which is treatment with high-energy rays to kill or shrink cancer cells. The radiation may come from outside of the body (external radiation) or from radioactive materials placed directly in a tumor (internal or implant radiation, sometimes called brachytherapy).
- o Chemotherapy, which is treatment with drugs to destroy cancer cells.
- o Surgery, which is the resection, or removal, of a tumor or organ of the body.

Some cancers, such as certain cancers of the liver, prostate, bone metastases and even lung cancer can be killed using heat alone. For these treatments we have developed the MicroThermX 100 thermal ablation system that is used to kill cancerous tumors at high temperatures as a stand-alone therapy. The treatment of many cancers is generally prescribed with one or more of the primary cancer therapies noted above. Because cancer remains a significant cause of death, these three cancer therapies are still grossly inadequate, and an enormous need for better treatment is obvious. We have engineered systems designed to increase the effectiveness of these cancer treatments through the use of precision-focused RF/microwave energy to selectively heat cancer, creating "hyperthermia" in cancerous tumors. Hyperthermia is an emerging cancer

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therapy that both kills cancer cells directly and has been shown to be a potent additive treatment in making certain of the major existing cancer therapies more effective for some cancers.

Hyperthermia therapy has been shown to substantially improve the results from cancer treatments for a variety of tumors. Completed randomized clinical trials in which the effectiveness of radiation therapy combined with hyperthermia therapy was compared with the results of radiation therapy alone in cancer treatment produced the following results: For melanoma, after two years, local control (local regression or disappearance of the tumor) was 28% for the control group of patients who received radiation therapy alone versus 46% local control for the patients who received both hyperthermia and radiation therapy. For recurrent breast cancer, the complete response rate (complete disappearance

5

of the tumor) increased from 38% for those receiving radiation therapy alone to 60% for those patients who received both hyperthermia and radiation therapy. For glioblastoma (brain cancer), the two-year survival rate for patients who received radiation therapy alone was 15%, compared to 31% survival rate two years after treatment for those who received both hyperthermia and radiation therapy. For advanced cervical cancer, the complete response rate (disappearance of the tumor) rose from 57% for patients who received radiation treatments alone to 83% for patients receiving both hyperthermia and radiation therapy. The cervical cancer data was based on the condition of patients three years after treatment.

Cancerous tumors are uncontrolled growths of mutated cells that require more energy to survive than do cells of normal tissue. As cancer cells grow rapidly, they tend to outstrip their blood supply, leaving them oxygen-starved, since there is not enough blood to carry sufficient oxygen to these cells. Oxygen-starved cancer cells are resistant to radiation therapy because the destructive power of radiation therapy depends heavily on tearing apart the oxygen molecules located in cancer cells. When oxygen molecules are torn apart, they form oxygen radicals that can attack and destroy cancer cell DNA. Blood depletion also makes cancer resistant to chemotherapy, where blood transport is required to deliver the drug into the tumor. Our hyperthermia therapy systems precisely deliver microwave energy to elevate the temperature of tumors, usually between 40 degrees C and 45 degrees C (104 degrees F to 113 degrees F). The elevated temperatures draw blood to the tumor as the body's natural response to the stimulus of heat. The increased blood supply to the tumor improves delivery of drugs to tumors in chemotherapy. It also delivers more oxygen to the tumor, increasing the effectiveness of radiation therapy.

While sensitizing tumors for more effective treatment from radiation and/or chemotherapy, hyperthermia also destroys cancer cells directly through damage to the plasma membrane, the cytoskeleton and the cell nucleus, and by disrupting the stability of cellular proteins. Tumors with poor blood supply systems lack the natural cooling capacity provided by efficient blood flow in normal tissues, making them selectively susceptible to the cancer-destructive effects of hyperthermia therapy.

Hyperthermia has other therapeutic uses. It can be used to shrink tumors prior to surgery, potentially making resection easier or even possible. Research has shown hyperthermia to be an activator for gene therapies by speeding gene production (heat mediated gene therapy). Hyperthermia may play a role in the development of new anti-tumor vaccines that are based on the production of heat shock proteins. Research has shown hyperthermia to be an angiogenesis inhibitor, which means it helps prevent cancer from inducing growth of new blood vessels to expand its blood supply. Hyperthermia could also become a follow-up therapy for other angiogenesis inhibitors, used in the final

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destruction of cancer cells depleted of blood by angiogenesis inhibitor therapy. Hyperthermia has been shown to improve a patient's quality of life. Even in situations where there is no hope for survival, hyperthermia may provide benefits through alleviation of such effects of cancer as bleeding, pain and infection.

Since the founding of the Company, we have been heavily involved in developing technological advances to expand the use of hyperthermia therapy for the treatment of cancer. Our efforts have included joint work with many notable cancer research centers in the United States and Europe. In past years, funding for our research efforts has been provided by such sources as the National Institutes of Health in the United States and major European government agencies. In recent years, we have focused our efforts in perfecting the

6

technology required to precisely deliver deep, non-invasive hyperthermia therapy for the treatment of pelvic and other deep cancers and to demonstrate effective use of deep hyperthermia through clinical trials. We believe that our BSD-2000 system has emerged from this development effort as the world's most advanced system for hyperthermia therapy.

We have developed various technologies for heating cancerous tumors, depending on their location in the body. Through our developments, cancers such as melanomas or recurrent breast cancer located near the surface of the body can be treated with superficial cancer treatment applicators and systems. Cancers that can be accessed through natural body orifices, or that are accessible through catheters inserted into the tumor as part of invasive radiation techniques (such as used to treat prostate cancer or head and neck cancer) can be treated with tiny, inserted antennae that we have developed to deliver focused microwave energy into the cancerous tissue. We have also developed systems to non-invasively treat cancers located deep in the body by focusing electromagnetic energy on the cancer through a cylindrical applicator that surrounds the body. This cylindrical applicator contains an array of multiple antennae that focus radio frequency energy, and therefore heat, on the tumor. Temperature levels for treatments are monitored through small temperature sensors, and some of our systems can be interfaced with magnetic resonance imaging, or MRI, so that the treatment in progress can be observed, and temperatures can be monitored through images colorized to depict gradation of temperature levels (thermography).

Our BSD-500 is used to treat cancers located near the surface of the body, or areas that can be accessed using inserted antennae. The BSD-500 comes in several versions, depending on the customer requirements. The BSD-2000 is used to non-invasively treat deep cancers. This system also comes in several versions, including models with three dimensional, or 3D, steering of electromagnetic energy, as well as the ability to be integrated with MRI.

The BSD-500 has received FDA approval. In addition, the system has gone through an extensive revision, and has obtained two major FDA supplements to this approval that have been necessary to allow its commercial introduction.

The BSD-2000 does not currently have FDA approval except as an investigational device, however, the phase III clinical trial that we will use to apply for the FDA approval has been concluded and published in a major journal. Formal submission for FDA approval of the BSD-2000 was made in March 2006. We sought and obtained regulatory approval for the sale of the BSD-2000 in the People's Republic of China during 2005.

The MicroThermX 100 thermal ablation system was announced in 2006 and does not yet have FDA approval. Submission for FDA approval is expected during

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2007, with a potential for obtaining a general FDA approval for the MicroThermX 100 during 2007.

Nearly all of our sales of cancer therapy systems over recent past periods have been to cancer research institutions for use in conducting clinical trials with our equipment. As a company, we are now in the early stages of marketing the new commercial version of the BSD-500. Obtaining FDA approval for the BSD-2000 would greatly contribute to our sales efforts by providing the additional technology required for the treatment of solid tumors located virtually anywhere in the body.

7

Our Products and Services

We have developed the technology and products required to approach thermal ablation and hyperthermia cancer therapy through three different techniques, which collectively allow cancer to be treated virtually anywhere in the body:

- o Thermal ablation destroys cancer at high temperatures through focused microwave energy.
- o Superficial hyperthermia non-invasively treats cancerous tumors located within a few centimeters of the surface of the body, such as melanoma and recurrent breast cancer.
- o Internal or interstitial hyperthermia treats tumors in combination with internal radiation therapy by inserting tiny microwave antennae that deliver hyperthermic microwave energy to tumors through the same catheters used to deliver radioactive materials, or "seeds," to tumors for radiation therapy. This technique can be employed in treating prostate cancer, breast cancer, head and neck cancer and a variety of other cancer sites.
- o Deep hyperthermia non-invasively treats tumors located deep within the body, including many problematic cancer sites located in the pelvis, abdomen and chest areas.

MicroThermX 100. Our MicroThermX 100 has been developed to treat cancerous tissue percutaneously, laparoscopically or surgically. The MicroThermX 100 utilizes precision-guided microwave energy to ablate cancerous tissue. The MicroThermX 100 includes a computer driven control system, temperature sensors and a disposable applicator. The system is currently being prepared for FDA 510(k) clearance. The advanced features and capabilities of the MicroThermX 100, were made possible by our years of research, design and development in the discipline of thermal medicine technology, supported by leading research centers throughout the world (see reference to these in the section for the BSD-2000).

Disposable applicators for the MicroThermX 100 are used to treat different types of tumors, and are especially designed according to the method by which they will be used in treatment, whether by surgeons or interventional radiologists.

BSD-500 Systems. Our BSD-500 systems are used to deliver either superficial or interstitial hyperthermia therapy or both. There are four configurations of the BSD-500. The BSD-500i-4 and BSD-500i-8 provide interstitial hyperthermia treatment using four or eight channel generators, respectively. Each channel can control three interstitial applicators. The BSD-500c-4 and BSD-500c-8 provide both superficial and interstitial hyperthermia

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treatments using four or eight channel generators. These systems include a touch screen display monitor by which the operator controls the hyperthermia treatment, computer equipment and software that controls the delivery of

8

microwave energy to the tumor, and a generator that creates the needed microwave energy for the treatment. Additionally, the systems include a variety of applicators, depending on each system configuration. Non-invasive superficial applicators are used for superficial hyperthermia treatments. For interstitial hyperthermia treatments, the system may include up to 24 tiny microwave heat-delivering antennae that are inserted into catheters used in the standard practice for internal radiation therapy (called brachytherapy).

We have received FDA approval through FDA supplements for implementation of a new operating system and other commercial upgrades, allowing us to commercially introduce this new family of four systems. Our primary FDA approval (described as a pre-market approval, or PMA, the standard FDA approval required to market Class III medical devices in the United States) for the BSD-500 family of systems is applicable to the marketing of all four configurations of the BSD-500 in the United States. We have also certified the BSD-500 systems for the CE Mark, which is required for export into some European countries.

BSD-2000. The BSD-2000 family of products includes the BSD-2000, the BSD-2000/3D and the BSD-2000/3D/MR. These systems non-invasively deliver hyperthermic microwave energy to cancerous tumors, including those located deep within the body. These systems include a computer and software that control the delivery of microwave energy to the tumor, a microwave energy generator, an amplifier that boosts the microwave power, and a special applicator that delivers the microwave energy to the patient lying in a prone position on a specially designed support table. The BSD-2000 systems are able to direct, focus and deliver microwave energy deep within the body by precisely "steering" the energy to the tumor from an array of cylindrical antennae. The basic BSD-2000 has eight microwave antennae enabling this electronic steering of energy within the patient's body. The BSD-2000/3D has 24 microwave antennae enabling additional electronic steering along the long axis of the body. The 3D steering is particularly useful when implemented with a magnetic resonance system that is capable of non-invasive 3D imaging showing the heated regions, thus permitting the 3D steering to more accurately target the energy to the tumor site.

The BSD-2000 systems have not yet received pre-market approval from the FDA for commercial marketing in the United States, but the BSD-2000 has obtained an investigational device exemption, or IDE, for sale in the United States for research purposes only. We have also certified the BSD-2000 family for the CE Mark required for export into certain European countries and have obtained regulatory approval for the sale of the BSD-2000 in the People's Republic of China. We are engaged in the extensive process of preparing an FDA submission requesting a PMA for the BSD-2000 based on clinical data we have already obtained. While we believe that this data has great merit and is worthy of submission, due to the inherent uncertainties of the FDA approval process there can be no assurance that FDA approval will be obtained through our submissions.

Development of the BSD-2000, the BSD-2000/3D and the BSD-2000/3D/MR has required substantial effort involving the cooperative work of such American research institutions as Duke University, Northwestern University, University of Southern California, Stanford University, University of Utah and University of Washington St. Louis. Contributing European research institutions include Daniel den Hoed Cancer Center of the Academisch Ziekenhuis (Rotterdam, Netherlands), Haukeland University Hospital (Bergen, Norway), Dusseldorf University Medical School, Tubingen University Medical School, Essen University Hospital, Charite

Medical School of Humboldt University (Berlin), Luebeck University Medical School, Munich University Medical School Grosshadern, Interne Klinik Argirov of the Munich Comprehensive Cancer Center, University of Erlangen (all of Germany), University of Verona Medical Center (Italy), Graz University Medical School (Austria) and Kantonsspital Aarau (Switzerland).

BSD-2000/3D. Through research funded by the National Cancer Institute in the United States and supportive efforts by other domestic and international research institutions, we enhanced the BSD-2000 to create the new BSD-2000/3D. The BSD-2000/3D adds three-dimensional steering of deep focused energy, as opposed to the two-dimensional steering of energy available in the BSD-2000, delivering even more precise heating the tumor. As part of our international collaborative research efforts, sophisticated treatment planning software for the BSD-2000/3D has also been developed.

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

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

We installed and tested the first BSD-2000/3D/MR system at a leading German oncological research institution, the Clinic of Medical Oncology of the Klinikum Gro(beta)hadern Medical School of Ludwigs-Maximilians-Universitat Munchen, in Munich, Germany. We installed a second BSD-2000/3D/MR system at the Department of Radiology of Charite University Medical School of Humboldt University in Berlin, Germany, as part of a collaborative effort with Siemens Medical Systems. The funding for purchase and development of these systems was provided by the German government and public foundation funds.

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

Sales, Marketing and Distribution

Our target market includes clinics, hospitals and institutes in which cancer is treated, whether in the Unites States or international markets.

In September 2004, we entered into an agreement with Dalian Orientech Co. LTD to assist us in obtaining regulatory approval for the sale of the BSD-2000 in the People's Republic of China, and thereafter to act as our distributor for the sale of the BSD-2000 in that country. We subsequently

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obtained Chinese regulatory approval during 2005, allowing the distributor to begin to market in that country, opening the way for BSD-2000 systems to be sold and installed in hospitals in China.

In August 2006, we engaged Richter7 as a public relations agency. Richter7 has broad experience in the medical and healthcare industry. They have worked with companies such as Medtronic, Ultradent, Myriad Genetics, Siemens, Stryker/Howmedica and others to build awareness and recognition of new products in the marketplace.

Anticipating an expanding need for present and future sales and marketing, especially with the potential FDA approval for the BSD-2000 and the MicroThermX 100, we hired Brian Ferrand, a seasoned Vice President of Sales, in September 2005, and have increased our sales, marketing and marketing support organization to ten people. The primary mission of this group is to provide sales and pre-market preparation for our systems.

Medizin Technik is our exclusive distributor of hyperthermia systems in Germany, Austria and Switzerland and to certain medical institutions in Belgium and the Netherlands. Medizin Technik is required to use best efforts to sell our product within its territory. Due to the limited number of systems that are sold through this relationship, we do not have pre-negotiated price terms with Medizin Technik. If Medizin Technik identifies a potential customer, it will negotiate the price of a hyperthermia system with us, purchase the system, and resell the system to the customer on terms it negotiates with the customer. Our distributorship agreement with Medizin Technik runs from year-to-year and may be terminated by either party by providing written notice to the other party before December 31 and automatically terminates upon the occurrence of certain events, including the retirement or death of Dr. Sennewald. Dr. Sennewald is a director and shareholder of BSD and of Medizin Technik.

Our sales and marketing strategy involves three main components:

- o promoting acceptance by the scientific community and cancer-treating healthcare professionals of hyperthermia therapy;
- o disseminating information about and marketing our hyperthermia therapy systems to the scientific community, cancer-treating healthcare professionals, cancer patients and the general public; and
- o working to continuously improve third-party reimbursement for medical services performed with our products.

We disseminate information about our company and our hyperthermia therapy systems by encouraging articles about hyperthermia therapy to be published in scientific journals, periodicals and other publications, and promoting dissemination of BSD information through television, radio and other media outlets. We post information about our products on our web site, www.BSDMedical.com, and our materials are also posted on many other sites. We have developed promotional materials for our products, including product brochures, patient brochures and newsletters. We also participate actively in trade shows and scientific symposia, make public presentations delivered by our scientific staff and by scientists and researchers using our systems, and we actively participate in a variety of medical associations. We are co-sponsors of the annual international BSD Users' Conference in Europe and are sponsors of the Society of Thermal Medicine and the American Society of Therapeutic Radiation and Oncology (ASTRO) in the United States.

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Third-Party Reimbursement

We view obtaining adequate third-party reimbursement arrangements as essential to achieving commercial acceptance of our hyperthermia therapy products. Our products are purchased primarily by clinics, hospitals and other medical institutions that bill various third-party payors, such as Medicare, Medicaid, other government programs and private insurance plans, for the health care services provided to their patients using our products. Additionally, managed care organizations and insurance companies directly pay for services provided to their patients. The Center for Medicare and Medicaid Services, or CMS, has established 23 billing codes that allow for third-party reimbursement and can be used for or in combination with the delivery of hyperthermia therapy, depending on the circumstances of the treatment. Appropriate codes apply to billing for superficial and interstitial hyperthermia delivered using our BSD-500 systems when used in combination with radiation therapy. Codes also have been established for providing deep hyperthermia therapy. Billing codes are available for both institutions and physicians.

In November 1995, HCFA, the predecessor agency to CMS, authorized Medicare reimbursement for all investigational therapies and devices for which underlying questions of safety and effectiveness of that device type have been resolved, based on categorization by the FDA. Our BSD-2000 system, which has been given IDE status by the FDA, has been placed in this category by the FDA, and thus may be reimbursed by Medicare.

Medical reimbursement rates are unpredictable, and we cannot project the extent to which our business may be affected by future legislative and regulatory developments. There can be no assurance that future health care legislation or regulation will not have a material adverse effect on BSD's business, financial condition and results of operations, or that reimbursement, existing or in the future, will be adequate for all customers.

Competition

Competition in the medical products industry is intense. We believe that established product lines and cancer therapies, FDA approvals, know-how and reputation in the industry are key competitive factors. Currently, only a few companies besides BSD have received FDA approval to manufacture and sell hyperthermia therapy systems within the United States, including U.S. Labthermics and Celsion Corporation. Celsion has been principally involved with clinical trials related to thermotherapy, hyperthermia and related fields, however Celsion has announced the transformation of its company from a medical device company to a biopharmaceutical, solely focused on the development of drugs for the treatment of cancer. Labthermics produces ultrasound-based systems, which compete with our microwave hyperthermia systems, however Labthermics is not currently active in the sale of products in our industry. Several other companies have received IDEs in the United States or other international clearance for certain experimental hyperthermia systems designed to treat both malignant and benign diseases. Additionally, other companies,

12

particularly established companies that currently manufacture and sell other cancer therapy systems, could potentially become competitors (in that they are also engaged in cancer treatment businesses), and they have significantly greater resources than we do.

Although we have not currently entered the thermal ablation market with cancer treatment systems, we anticipate that future competitors in that market

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will include RadioTherapeutics, a division of Boston Scientific Corporation, Valleylab, a division of Tyco Healthcare, which is a division of Tyco International, and Rita Medica. Microsulis Limited is developing microwave technologies for tumor ablation, but is not commercially active in selling tumor ablation systems at this time.

Product Service

We provide a 12-month warranty and record a liability for the warranty following installation on all cancer treatment systems and a 90-day limited warranty on individual components. We install and service the hyperthermia systems we sell to domestic customers. In addition, we or our consultants provide technical and clinical training to our customers. Subsequent to the applicable warranty period, we offer our domestic customers full or limited service contracts.

Generally, our distributors install and service systems sold to foreign customers and are responsible for managing their own warranty programs for their customers, including labor and travel expenses. We provide warranties for the replacement and/or repair of parts for 12 months for systems sold internationally through distributors and for 90 days for individual components. Spare parts are generally purchased by the distributors and stored at the distributors' maintenance facilities to allow prompt repair. Distributor service personnel are usually trained at customer sites and at our facilities in Salt Lake City, Utah.

Production

We manufacture and test our systems and products at our facilities in Salt Lake City, Utah. Our manufacturing facility is ISO 9001-1994 certified and follows FDA quality systems regulations. Some equipment components we purchase from suppliers are customized to our specifications. Key factors in our manufacturing process are assembly and testing. We purchase component parts and other materials from a variety of suppliers. We do not depend on a single supplier for any item, and believe we can acquire materials and parts from multiple sources on a timely basis.

Product Liability Exposure

The manufacturing and marketing of medical devices involves an inherent risk of product liability. Because our products are intended to be used in hospitals on patients who may be physiologically unstable and severely ill, we are exposed to potential product liability claims. We presently carry product

13

liability insurance with coverage limits of \$1 million. However, we cannot assure you that our product liability insurance will provide adequate coverage against potential claims that might be made against us. No product liability claims are presently pending against us; however, we cannot assume that product liability claims will not be filed in the future or that such claims will not exceed our coverage limits.

Government Regulation

The medical devices that we have developed and are developing are

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subject to extensive and rigorous regulation by numerous governmental authorities, principally by the United States Food and Drug Administration, or FDA, and comparable foreign agencies. Pursuant to the Federal Food, Drug and Cosmetic Act, as amended, the FDA regulates and must approve the clinical testing, manufacture, labeling, distribution, and promotion of medical devices in the United States.

Although our MicroThermX 100 system will be filed for FDA approval as a 510(k) submission, most of our hyperthermia treatment systems, including the BSD-500 and the BSD-2000 and related products, have required or require pre-market approval from the FDA instead of the simpler 510(k) approval. Pre-market approval requires that we demonstrate that the medical device is safe and effective. To do this, we conduct either laboratory and/or clinical testing. The FDA will grant approval of the product if it determines there is reasonable assurance that the medical device is safe and effective. FDA approval must be obtained before commercial distribution of the product. We intend to continue to make improvements in and to our existing products. Significant product changes must be submitted to the FDA under investigational device exemptions, or IDEs, or under pre-market approval supplements. As described in the section entitled "Our Products and Services" above, we have obtained a PMA for our BSD-500 systems and IDE status for our BSD-2000 system. A PMA submission was made to the FDA for the BSD-2000 in March 2006.

Foreign countries, in which our products are or may be sold, have regulatory requirements that can vary widely from country to country. Sales into the European Union, or EU, require compliance with the Medical Devices Directive, or MDD, and require us to obtain the necessary certifications to have a CE Mark affixed to our products. We have obtained necessary ISO certification of our quality, development, and manufacturing processes, and we have successfully completed the CE Mark testing and Annex II audit. This allows us to certify our own products and to affix the CE Mark label on them. However, we must maintain compliance with all current and future directives and requirements to maintain ISO certification and to continue to affix the CE Mark, and there can be no assurance that we will continue to maintain compliance with regulatory requirements imposed on us.

After we receive FDA approval to distribute a medical device, we continue to have ongoing responsibilities under the Federal Food, Drug, and Cosmetic Act and FDA regulations. The FDA reviews design and manufacturing practices, labeling, record-keeping, and required reporting of adverse experiences. All medical devices must be manufactured in accordance with regulations specified in the FDA Quality System regulations, or QSR, and in compliance with the ISO and other applicable standards. In complying with these regulations, we must continue to expend time, money and effort in the areas of

design control, production, and quality control to ensure full compliance. The FDA's mandatory Medical Device Reporting regulation requires us to provide information to the FDA on death or serious injuries alleged to have been associated with the use of our products, as well as information on product malfunctions that would likely cause or contribute to a death or serious injury if the malfunctions were to recur. In Europe, the MDD vigilance system regulations require that we, through a representative in Europe, provide information to authorities on death or serious injuries alleged to have been associated with the use of our products, as well as information on product malfunctions that would likely cause or contribute to a death or serious injury if the malfunctions were to recur. If the FDA were to assert that we are not in compliance with applicable laws or regulations, or that any of our medical devices are ineffective or pose an unreasonable risk to patient health, the FDA could seize our medical devices, ban such medical devices, or order a recall,

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repair, replacement or refund of such devices, and require us to notify health care professionals and others that the devices present unreasonable risk of substantial harm to the public. The FDA may also impose operating restrictions, restrain certain violations of law, and assess civil or criminal penalties against us. The FDA can also recommend prosecution to the Department of Justice. Certain regulations are subject to administrative interpretation and we cannot assure that future interpretations made by the FDA or other regulatory bodies, with possible retroactive effect, will not adversely affect us.

International sales of medical devices are subject to FDA export requirements. We have obtained export approvals for all countries into which we have delivered products. This includes countries in Western Europe and much of Eastern Europe and many Asian countries.

International sales are subject to the regulatory and safety requirements of the country into which the sale occurs. There can be no assurance that all of the necessary approvals will be granted on a timely basis or at all. Delays in receipt of or failure to receive such approvals would have a material adverse effect on our financial condition and results of operations.

In addition to FDA regulations, certain U.S. health care laws apply when a claim for reimbursement for one of our medical devices is submitted to Medicare, Medicaid, or other federal health care programs. For instance, federal law prohibits the filing of false or improper claims for federal payments. In addition, federal law prohibits the payment of anything of value for the purpose of inducing referrals of business reimbursable under a federal health care program. Other federal laws prohibit physicians from making referrals for certain services and items payable under certain federal programs if the physician has a financial relationship with the entity providing the service or item.

All of these laws are subject to evolving interpretations. If the federal government were to conclude that we are not in compliance with any of these health care laws, we could be subject to substantial criminal and civil penalties, and could be excluded from participation as a supplier to beneficiaries in federal health care programs.

The Federal Communications Commission, or FCC, regulates the frequencies of microwave and radio frequency emissions from medical and other types of equipment to prevent interference with commercial and governmental communications networks. The BSD-500 fixed frequency systems and applicators emit 915 MHz for U.S. and some European installations and 433.92 MHz for some

15

European installations, which is approved by the FCC for medical applications. Accordingly, these systems do not require shielding to prevent interference with communications. Our BSD-2000 deep hyperthermia variable-frequency generators and applicators require electromagnetic shielding.

Patents, Licenses, and Other Rights

Because of the substantial length of time and expense associated with bringing new products through development and regulatory approval to the marketplace, the medical device industry places considerable importance on obtaining patent and trade secret protection for new technologies, products and processes. Our policy is to file patent applications to protect significant technology, inventions and product improvements. We currently own five patents in the United States and eight patents outside the United States. In addition, five initial patents were assigned to TherMatrx, for which we obtained a

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license, four subsequent patents were obtained and assigned to TherMatrix, and we obtained one patent license from the National Institutes of Health. Three new U.S. patent applications are pending. We believe that our patents represent the early pioneering and dominant patents in this field.

In July 1979, we entered into an exclusive worldwide license for a unique temperature probe called the Bowman Probe. The license will remain in effect as long as the technology does not become publicly known as a result of actions taken by the licensor. We pay royalties based upon our sales of the Bowman Probe. The license agreement was amended and renewed in August 2000 and is currently in effect.

We also acquired on December 13, 2001 a patent license from the National Institutes of Health (NIH) for the U.S. Patent 5,284,114. This patent is for the integration of magnetic resonance with hyperthermia systems, including our BSD-2000/3D/MR system, and is based on a patent obtained by NIH in early research of the concept. The license agreement requires an annual payment of \$1,000, plus \$4,000 per licensed product sold in the U.S., and \$1,000 per licensed product manufactured in the U.S. and sold outside the U.S. There is also to be a single payment of \$10,000 upon PMA or 510(k) FDA approval.

On July 1, 2001, we acquired the rights to all FDA approvals and the rights to manufacture all cancer products formerly owned by Clini-Therm Corp. These products are related to the hyperthermia therapy delivered by our BSD-500 systems, the exclusive patent obtained from UCSF, and our enhancements to such systems involve incorporating some of the Clini-Therm rights we acquired into such systems. This involved only a one-time cash payment with no continuing costs.

We cannot assure that the patents presently issued to us will be of significant value to us in the future or will be held valid upon judicial review. Successful litigation against these patents by a competitor would have a material adverse effect upon our business, financial condition and results of operations. We believe that we possess significant proprietary know-how in our hardware and software capabilities. However, we cannot assure that others will not develop, acquire or patent technologies similar to ours or that such secrecy will not be breached.

16

Research and Development

Research and development expenses for fiscal 2006 were \$1,251,956 compared to \$859,614 for fiscal 2005, an increase of \$392,342, or 46%. Research and development expenses in fiscal 2006 related to the following:

- o completion of our commercial version of the BSD-2000 with complete modernization of the computer system
- o addition of the Sigma Ellipse phased array applicator
- o a complete new design of the BSD-2000 patient support system
- o enhancements to the BSD 500 and 2000 systems including language translations to German and Chinese
- o development of various spiral array applicator systems to compliment the BSD-500
- o completion of regulatory certifications of the improvements of the

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BSD-500 and BSD-2000 systems

- o PMA filing for the BSD-2000 system
- o development of the first model of the MicroThermX 100 microwave ablation system
- o development of new microwave ablation disposable applicators and technical research to evaluate the various treatment sites and diseases suitable for the application of the MicroThermX 100.

Technological changes play an important part in the advancement of our industry. We intend to continue to devote substantial sums to research and development. Research and development efforts inherently involve costs, risks and uncertainties that could adversely affect our projections, outlook and operating results.

Company History

BSD was originally incorporated under the laws of the State of Utah on March 17, 1978. In July 1986, BSD was reincorporated in Delaware.

Employees

As of August 31, 2006, we had 39 employees; 36 of whom were full time employees. None of our employees is covered by a collective bargaining agreement. We consider our relations with our employees to be satisfactory. We depend upon a limited number of key management, manufacturing, and technical personnel. Our future success will depend in part on our ability to retain these highly qualified employees.

17

Risks Related to Our Business

Our future operating results are highly uncertain. Before deciding to invest in BSD Medical or to maintain or increase your investment, you should carefully consider the risks described below, in addition to the other information contained in this annual report on Form 10-KSB. If any of these risks actually occur, our business, financial condition or results of operations could be seriously harmed. In that event, the market price for our common stock could decline and you may lose all or part of your investment.

We have a history of significant operating losses and such losses may continue in the future.

Since our inception in 1978, our expenses have substantially exceeded our revenue, resulting in continuing losses and an accumulated deficit of \$8,751,454 at August 31, 2005. In fiscal 2006, we recorded a net profit of \$9,249,496 which eliminated the accumulated deficit and resulted in positive retained earnings of \$498,042.

Our net profit was primarily due to the sale of our ownership in TherMatrx, to American Medical Systems Holdings, Inc., or AMS. Substantially all revenues from this sale have now been received with no significant future revenues expected. We may continue to incur operating losses in the future as we continue to incur costs to develop our products, protect our intellectual property and expand our sales and marketing activities. To become profitable we

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will need to increase significantly the revenues we receive from sales of our hyperthermia therapy products to sustain and increase our profitability on a quarterly or annual basis. We have been unable to do this in the past and we may be unable to do so in the future, and therefore may never achieve profitability.

Our hyperthermia therapy products may not achieve market acceptance which could limit our future revenue and ability to achieve profitability.

To date, hyperthermia therapy has not gained wide acceptance by cancer-treating physicians. We believe this is due in part to the lingering impression created by the inability of early hyperthermia therapy technologies to focus and control heat directed at specific tissue locations and conclusions drawn in early scientific studies that hyperthermia was only marginally effective. Additionally, market acceptance depends upon physicians and hospitals obtaining adequate reimbursement rates from third-party payors to make our products commercially viable, and we believe that reimbursement rates have not been adequate to stimulate strong interest in adopting hyperthermia as a new cancer therapy. If our sales and marketing efforts to promote hyperthermia therapy acceptance in the medical community fail, or our efforts to improve third-party reimbursement rates for hyperthermia therapy are not successful, then our future revenue from sales of our products may be limited, and we may never be able to obtain profitable recurring operations.

Sales of our product could be significantly reduced if government, private health insurers and other third-party payors do not provide sufficient coverage or reimbursement.

Our success in selling our products will depend in large part on the extent to which reimbursement for the costs of our products and related treatments are available from government health agencies, private health insurers and other third-party payors. Despite the existence of general

18

reimbursement policies, local medical review policies may differ for public and private insurance payors, which may cause payment to be refused for some hyperthermia treatments. Private payors also may refuse to pay for hyperthermia treatments.

Medical reimbursement rates are unpredictable and we cannot predict the extent to which our business may be affected by future legislative and regulatory developments. Future health care legislation or regulation may limit our business or impose additional delays and costs on our business and third-party reimbursement may not be adequate to cover our costs associated with producing and selling our products.

Cancer therapy is subject to rapid technological change and therapies that are more effective than ours could render our technology obsolete.

The treatment of cancer is currently subject to extensive research and development. Many cancer therapies are being researched and our products may be rendered obsolete by existing therapies and as a result of therapy innovations by others. If our products are rendered obsolete, our revenue will decline, we may never achieve profitability, and we may not be able to continue in business.

Some of the medical institutions to which we have sold in the past have not been able to pay for their equipment, and some of our sales have therefore become substantial bad debts, a risk that could continue into the future.

A limited number of our customers have been developing clinics, and these customers have been particularly vulnerable to financial difficulties that

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can cause them to be unable to pay for equipment that they have purchased. If we choose to accept higher risk sales opportunities to clinics in the future, we will be subject to these customer credit risks that could lower future net sales due to bad-debt write offs, resulting in losses in future periods and potentially lowering the value of your stock. While we attempt to provide for foreseeable doubtful accounts, we cannot assure you that this provision will always be adequate to cover our credit risks.

Increasing sales of our hyperthermia systems depends on our ability to successfully expand our sales distribution channels; we have had failures with the productivity of new channels of distribution in the past. Expanding our channels of distribution will also significantly increase our sales expenses, which could negatively impact our financial performance.

We believe that the success of our efforts to increase sales of our hyperthermia systems in the future depends on our ability to successfully expand our sales distribution channels. Historically, we have sometimes failed in establishing successful new sales channels.

We anticipate that the success of our multi-year plan for selling hyperthermia systems will require expanding our sales and marketing organization through a combination of direct sales people, distributors and internal and external marketing expertise. However, as we pursue our marketing plan, there can be no assurance that we will be successful in securing reliable channels of distribution to meet our plan through expanded sales. Recruiting and training

19

new distribution channels can take time and considerable expense. We project that sales and marketing expenses will increase substantially in the future as compared to past years. This added expense could have an adverse effect on our future financial performance that is greater than any potential increases in sales.

In addition, there can be no assurance that our channels of distribution that have been successful in the past will be successful in the future. We have derived most of our revenue from sales in Europe through our distributor Medizin-Technik, GmbH, which also purchases equipment components and parts from us. Medizin-Technik is controlled by Dr. Sennewald, one of our directors. The loss or ineffectiveness of Medizin-Technik as a distributor and significant customer could result in lower revenue.

We are subject to government regulations that can delay our ability to sell our products and cause us to incur substantial expenses.

Our research and development efforts, pre-clinical tests and clinical trials, and the manufacturing, marketing, distribution and labeling of our products are subject to extensive regulation by the FDA and comparable international agencies. The process of obtaining FDA and other required regulatory approvals is lengthy and expensive and our financial resources are limited.

We have not yet received pre-market approval for our BSD-2000 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. 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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After a product is approved for commercial distribution by the FDA, we have ongoing responsibilities under the Federal Food, Drug, and Cosmetic Act and FDA regulations, including regulation of our manufacturing facilities and processes, labeling and record-keeping, and reporting of adverse experiences and other information. Failure to comply with these ongoing requirements could result in the FDA imposing operating restrictions on us, enjoining or restraining certain violations, or imposing civil or criminal penalties on us.

We depend on adequate protection of our patent and other intellectual property rights to stay competitive.

We rely on patents, trade secrets, trademarks, copyrights, know-how, license agreements and contractual provisions to establish and protect our intellectual property rights. Our success will substantially depend on our ability to protect our intellectual property rights and maintain rights granted to us through license agreements. Our intellectual property rights may only afford us limited protection and may not adequately protect our rights or remedies to gain or keep any advantages we may have over our competitors, which could reduce our ability to be competitive and generate sales and profitability.

20

In the past, we have participated in substantial litigation regarding our patent and other intellectual property rights in the medical device industry. We have previously filed lawsuits for patent infringement against three of our competitors and subsequently settled all three of those lawsuits. Additional litigation against other parties may be necessary in the future to enforce our intellectual property rights, to protect our patents and trade secrets, and to determine the validity and scope of our proprietary rights. This litigation may require more financial resources than are available to us. We cannot guarantee that we will be able to successfully protect our rights in litigation. Failure to successfully protect our rights in litigation could reduce our ability to be competitive and generate sales and profitability.

A product liability settlement could exceed our ability to pay.

The manufacturing and marketing of medical devices involves an inherent risk of product liability. Because our products are intended to be used in hospitals on patients who may be physiologically unstable and severely ill, we are exposed to potential product liability claims. We presently carry product liability insurance with coverage limits of \$1 million. Our product liability insurance does not cover intended injury, injury or damage resulting from the intoxication of any person, payment of workers' compensation benefits, injury of our own employee, injury or damage due to war, damage to property that we own, damage to our work, loss of use of property, patent infringements, pollution claims, interest payments, depreciation of property, or injury or damage resulting from asbestos inhalation. We are responsible to pay the first \$10,000 resulting from any claim up to a maximum of \$50,000 in one year. We cannot assure you that our product liability insurance will provide adequate coverage against potential claims that might be made against us. If we were to be subject to a claim in excess of our coverage or to a claim not covered by our insurance and the claim succeeded, we would be required to pay the claim from our limited resources, which would reduce our limited capital resources and liquidity and reduce capital we could otherwise use to obtain approvals for and market our products. In addition, liability or alleged liability could harm our business by diverting the attention and resources of our management and by damaging our reputation.

We are dependent upon key personnel, some of whom would be difficult to replace.

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Our success will be largely dependent upon the efforts of Paul F. Turner, our Chairman of the Board, Senior Vice President, and Chief Technology Officer, Hyrum A. Mead, our President, and Dixie T. Sells, our Vice President of Regulatory Affairs, and other key employees. We do not maintain key-person insurance on any of these employees. Our future success also will depend in large part upon our ability to identify, attract and retain other highly qualified managerial, technical and sales and marketing personnel. Competition for these individuals is intense. The loss of the services of any of our key personnel, the inability to identify, attract or retain qualified personnel in the future or delays in hiring qualified personnel could make it more difficult for us to manage our business and meet key objectives such as the sale of our products and the introduction of new products.

The market for our stock is limited and our stock price may be volatile.

The market for our common stock has been limited due to low trading volume and the small number of brokerage firms acting as market makers. Because of the limitations of our market and volatility of the market price of our stock, investors may face difficulties in selling shares at attractive prices

21

when they want to. The average daily trading volume for our stock has varied significantly from week to week and from month to month, and the trading volume often varies widely from day to day. The following factors could impact the market for our stock and cause further volatility in our stock price:

- o announcements of new technological innovations;
- o FDA and other regulatory developments;
- o changes in third-party reimbursements;
- o developments concerning proprietary rights;
- o third parties receiving FDA approval for competing products; and
- o market conditions generally for medical and technology stocks.

Our directors and executive officers own a sufficient number of shares of our capital stock to control our company, which could discourage or prevent a takeover, even if an acquisition would be beneficial to our stockholders.

Our directors and executive officers own approximately 46% of our outstanding voting power. Accordingly, these stockholders, individually and as a group, may be able to influence the outcome of stockholder votes involving the election of directors, the adoption or amendment of provisions in our certificate of incorporation and bylaws and the approval of certain mergers or other similar transactions, such as a sale of substantially all of our assets. Such control by existing stockholders could have the effect of delaying, deferring or preventing a change in control of our company.

Anti-takeover provisions in our certificate of incorporation may have a possible negative effect on our stock price.

Certain provisions of our certificate of incorporation and bylaws may make it more difficult for a third party to acquire, or discourage a third party from attempting to acquire, control of us. We have in place several anti-takeover measures that could discourage or prevent a takeover, even if an

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acquisition would be beneficial to our stockholders. The increased difficulties faced by a third party who wishes to acquire us could adversely affect our stock price.

ITEM 2. DESCRIPTION OF PROPERTIES

Our office, production and research facilities are located in Salt Lake City, Utah. The complete headquarters and production facility occupies approximately 20,000 square feet. In November 2002, we renewed our lease for five years, which includes payments of approximately \$82,000 per year for five years adjusted annually for increases in the cost of living based on the Consumer Price Index for Urban Consumers. We have an option to purchase the building for \$1,000,000 upon 60 days notice for six years beginning December 1, 2002. Thereafter, the purchase price increases by \$50,000 each year, and the

22

option expires at the end of the tenth year. The building lease is accounted for as an operating lease for financial statement purposes. The building is currently in good condition, is adequate for our needs, is suitable for all company functions and provides room for future expansion. We believe that we carry adequate insurance on the property. Our lease on this building expires in November of 2007.

ITEM 3. LEGAL PROCEEDINGS

There are no legal proceedings pending against or being taken by BSD Medical Corporation.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company's Annual Meeting of Shareholders was held on February 13, 2006. Of the 20,519,632 shares of common stock outstanding and entitled to vote at the meeting, 14,096,138 shares were present, either in person or by proxy. The following proposals were submitted to a vote of security holders at the meeting;

1. To elect six members of the Board of Directors to serve until the next annual meeting of the Company and their successors have been duly appointed and are qualified.
2. To approve and ratify an amendment to the 1998 Director Stock Plan to extend the term of the plan and to increase the compensation paid to directors under the plan.
3. To ratify the selection of Tanner LC as the Company's independent registered public accounting firm for the fiscal year ending August 31, 2006.

The above proposals were approved and the results of the voting are summarized in the following table:

| | Proposal | For | Against | Withheld | Abstain |
|----|---------------------------|------------|---------|----------|---------|
| | ----- | --- | ----- | ----- | ----- |
| 1. | Elect Board of Directors: | | | | |
| | o Paul F. Turner | 14,019,420 | -- | 76,718 | -- |

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| | | | | | |
|----|--|------------|---------|--------|--------|
| | o Hyrum A. Mead | 14,027,420 | -- | 68,718 | -- |
| | o Gerhard W. Sennewald | 14,018,820 | -- | 77,318 | -- |
| | o Steven G. Stewart | 14,062,120 | -- | 34,018 | -- |
| | o Michael Nobel | 14,070,120 | -- | 26,018 | -- |
| | o Douglas P. Boyd | 14,062,120 | -- | 34,018 | -- |
| 2. | Approve and ratify an amendment to the 1998 Director Stock Plan | 13,930,382 | 163,906 | -- | 23,350 |
| 3. | Ratify selection of Tanner LC as independent registered public accounting firm | 14,076,780 | 8,335 | -- | 11,023 |

23

PART II

ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND SMALL BUSINESS

ISSUER PURCHASES OF EQUITY SECURITIES

On July 9, 2005, the American Stock Exchange approved the listing for BSD Medical Corporation and the shares began trading on that day under the symbol "BSM". The following table sets forth the high and low bid transactions, as provided by the OTC Bulletin Board and AMEX for the quarters in fiscal year 2005 and 2006. The amounts reflect inter-dealer prices, without retail mark-up, markdown or commission, and may not represent actual transactions.

| Quarter Ended: | Bid | |
|------------------------|------|------|
| | High | Low |
| November 30, 2004..... | 1.85 | 1.25 |
| February 28, 2005..... | 2.70 | 1.70 |
| May 31, 2005..... | 3.00 | 2.15 |
| August 31, 2005..... | 6.63 | 2.20 |
| November 30, 2005..... | 9.47 | 4.25 |
| February 28, 2006..... | 5.78 | 4.10 |
| May 31, 2006..... | 7.13 | 4.40 |
| August 31, 2006..... | 6.15 | 4.40 |

As of August 31, 2006, there were approximately 542 holders of record of our common stock. We have not paid any cash dividends on our common stock since our inception.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

This Management's Discussion and Analysis or Plan of Operation and other parts of this annual report on Form 10-KSB contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can also be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsections entitled "Forward-Looking Statements" and "Factors That May Affect Future Results and Financial Condition" below and the subsection entitled "Risk

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Factors" above. The following discussion should be read in conjunction with our consolidated financial statements and notes thereto included in this annual report on Form 10-KSB. All information presented herein is based on our fiscal year ended August 31, 2006. We assume no obligation to revise or update any forward-looking statements for any reason, except as required by law.

24

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 for cancer as provided through microwave/RF systems.

On July 15, 2004 TherMatrx, Inc. was sold to American Medical Systems Holdings, Inc. (AMS). Our part of the total proceeds from this sale was approximately 25%. A portion of the payout from the sale was based on contingency payments. By the close of fiscal 2006 we had received the last of the contingency payments from the TherMatrx sale. The total payout to us, including contingency payments, was approximately \$33.5 million.

Our accumulated deficit since inception decreased from \$8,751,454 as of August 31, 2005, to positive retained earnings of \$498,042 as of August 31, 2006 due to net income for fiscal 2006 of \$9,249,496 as compared to a net income of \$3,321,692 in fiscal 2005. The primary reason for the net income in fiscal 2006 and fiscal 2005 was the income generated from the sale of our ownership in TherMatrx.

We recognize revenue from the sale of cancer treatment systems, the sale of parts and accessories related to the cancer treatment systems, the sale of software license rights, providing manufacturing services, training, and service support contracts. Product sales were \$2,706,214 and \$1,844,321 for the years ended August 31, 2006 and 2005, respectively. Service revenue was \$192,188 and \$176,783 for the years ended August 31, 2006 and 2005, respectively.

We derived \$689,086, or 24%, of our revenue in fiscal 2006 from sales to related parties. All of the related party revenue was for the sale of the BSD-2000 and BSD-500 systems and component parts sold to Medizin-Technik GmbH. Dr. Gerhard Sennwald, one of our directors, is a stockholder, executive officer and a director of Medizin-Technik GmbH.

In fiscal 2006, we derived \$2,209,316, or 76%, of our total revenue as compared to \$1,033,632, or 51%, in fiscal 2005 from non-related party sales. Our fiscal 2006 non-related party revenue consisted of sales of BSD-500 and BSD-2000 systems for approximately \$1,902,175. The balance of our non-related party revenue consisted of consumable devices of \$126,896, service contracts of \$18,245, billable labor of \$17,250 and consulting revenue of \$144,750.

Cost of sales for the year ended August 31, 2006 included raw material and labor costs. Research and development expenses include expenditures for new product development and development of enhancements to existing products.

25

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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, so 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 guaranteed by BSD. 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, which approximates recognizing it as it is earned.

Our revenue recognition policy is the same for sales to both related parties and non-related parties. We provide the same products and services under the same terms for non-related parties as with related parties. Sales to distributors are recognized in the same manner as sales to end-user customers. Deferred revenue and customer deposits payable include amounts from service contracts as well as cash received for the sales of products, which have not been shipped.

Inventory Reserves. As of August 31, 2005, we had recorded a reserve for potential inventory impairment of \$80,000. During fiscal 2006, we reduced our inventory reserve from \$80,000 to \$40,000. In addition to the reduction of inventory reserve we also wrote off \$24,003 in obsolete inventory. We periodically review our inventory levels and usage, paying particular attention to slower-moving items. If projected sales for fiscal 2007 do not materialize or if our hyperthermia systems do not receive increased market acceptance, we may be required to increase the reserve for inventory in future periods.

Product Warranty. We provide product warranties on our BSD-500 and BSD-2000 systems. These warranties vary from contract to contract, but generally consist of parts and labor warranties for one year from the date of sale. 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

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

Results of Operations: Comparison of Fiscal Years ended August 31, 2006 and 2005

Revenue. Total revenue for fiscal 2006 was \$2,898,402 compared to \$2,021,104 for fiscal 2005, an increase of \$877,298, or 43%. The increase in total revenue was primarily due to an increase in sales of our BSD-2000 and BSD 500 systems during fiscal 2006. Product sales increased to \$2,706,214 in fiscal 2006 from \$1,844,321 in fiscal 2005, an increase of \$861,893, or 47%. Service revenue increased to \$192,188 in fiscal 2006 as compared to \$176,783 in fiscal 2005 primarily due to an increase in consulting revenue. Our revenue 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.

Related Party Revenue. We derived \$689,086, or 24%, of our total revenue in fiscal 2006 from sales to related parties as compared to \$987,472, or 49%, in fiscal 2005. All of the related party revenue in fiscal 2006 was for BSD-2000 and BSD-500 systems and various component parts sold to Medizin-Technik. Sales to Medizin-Technik may fluctuate significantly depending on Medizin-Technik's anticipated sales and ability to place orders in Europe. Since the sale of our ownership in TherMatrx we no longer consider TherMatrx a related party.

Non-related Party Revenue. In fiscal 2006, we derived \$2,209,316, or 76%, of our total revenue as compared to \$1,033,632, or 51%, in fiscal 2005 from non-related party sales. Our fiscal 2006 non-related party revenue consisted of sales of BSD-500 and BSD-2000 systems for \$1,902,175. The balance of our non-related party revenue consisted of consumable devices of \$126,896, service contracts of \$18,245, billable labor of \$17,250 and consulting revenue of \$144,750.

Cost of Sales. Cost of sales for fiscal 2006 was \$1,716,640 compared to \$1,320,110 for fiscal 2005, an increase of \$396,530 or 30%. This increase resulted primarily from higher sales in fiscal 2006. Cost of sales to related parties in fiscal 2006 decreased to \$371,214 from \$644,980, in fiscal 2005 primarily due to the decrease in related party sales. During fiscal 2006 and 2005 all of the related party costs were attributable to sales to Medizin-Technik.

Gross Profit. Gross profit for the fiscal year ending August 31, 2006 was \$1,181,762, or 41%, as compared to \$700,994, or 35%, of total product sales for the fiscal year ended August 31, 2005. The increase in gross profit margin was primarily due to production efficiencies obtained from a higher volume of hyperthermia system sales in the fiscal year ended August 31, 2006.

27

Research and Development Expenses. Research and development expenses for fiscal 2006 were \$1,251,956 compared to \$859,614 for fiscal 2005, an increase of \$392,342, or 46%. Research and development expenses in fiscal 2006

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related to the following:

- o completion of our commercial version of the BSD-2000 with complete modernization of the computer system, addition of the Sigma Ellipse phased array applicator
- o a complete new design of the BSD-2000 patient support system, enhancements to the BSD 500 and 2000 systems including language translations of the operating manuals to German and Chinese development of various spiral array applicator systems to compliment the BSD-500
- o completion of regulatory certifications of the improvements of the BSD-500 and BSD-2000 systems
- o PMA filing for the BSD-2000 system, development of the first model of the MicroThermX 100 microwave ablation system
- o and development of new microwave ablation disposable applicators
- o technical research to evaluate the various treatment sites and diseases suitable for the application of the MicroThermX 100.

Inventory Impairment Expense. As of August 31, 2005, we had recorded a reserve for potential inventory impairment of \$80,000. During fiscal 2006, we reduced our inventory reserve from \$80,000 to \$40,000. In addition to the reduction of inventory reserve we also wrote off \$24,003 in obsolete inventory.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for fiscal 2006 were \$5,028,957 as compared to \$2,135,076 in fiscal 2005, an increase of \$2,893,881, or 136%. This increase was primarily due to increases in sales and marketing expense, and overall higher payroll and employee benefits in fiscal 2006 as compared to fiscal 2005.

Interest Income. Interest income increased to \$1,301,341 in fiscal 2006 as compared to \$362,462 in fiscal 2005 due to increased investments, including cash, generated from the sale of TherMatrix.

Other Income. Other income for fiscal 2006 was \$18,256,306 compared to \$6,555,926 in fiscal 2005. This income resulted almost entirely from a gain recognized on the sale of TherMatrix in fiscal 2006 and 2005.

Provision for Income Taxes. Income tax expense increased to \$5,209,000 for fiscal 2006 from \$1,303,000 in fiscal 2005.

28

Net Profit/ Loss. In fiscal 2006, we had after-tax net income of \$9,249,496 as compared to after tax net income in fiscal 2005 of \$3,321,692. The increase in after-tax net profit related to the sale of our interest in TherMatrix.

Fluctuation in Operating Results. Our results of operations have fluctuated in the past and may fluctuate in the future from year to year as well as from quarter to quarter. Revenue may fluctuate as a result of factors relating to the demand for thermotherapy systems and component parts supplied by us to TherMatrix, market acceptance of our BSD hyperthermia systems, changes in the medical capital equipment market, changes in order mix and product order configurations, competition, regulatory developments and other matters. Operating expenses may fluctuate as a result of the timing of sales and marketing activities, research and development and clinical trial expenses, and

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general and administrative expenses associated with our potential growth. For these and other reasons described elsewhere, our results of operations for a particular period may not be indicative of operating results for any other period.

Liquidity and Capital Resources

Since inception, we have generated accumulated retained earnings of \$498,042. We have historically financed our operations through cash from operations, research grants, licensing of technological assets and issuance of common stock. As of August 31, 2006, we had cash and available for sale securities of \$24,735,200 as compared to cash and available for sale securities of \$13,527,197 as of August 31, 2005.

We used \$6,883,132 of cash in operating activities in fiscal 2006 compared to cash used of \$2,723,482 in fiscal 2005. This was primarily a result of gains on the sale of our TherMatrx shares of \$18,016,272 and net income of \$9,249,496. In addition, in fiscal 2006 accounts receivable increased by \$922,163, accounts payable increased by \$252,583, inventories increased by \$231,911, income tax payable increased by \$2,271,469 and accrued expenses increased by \$296,737. Our investing activities resulted in net cash provided of \$7,729,216 relating to the proceeds of our sale in TherMatrx of \$18,016,272 offset by purchase of investments of available for sale securities of \$10,073,884 and the purchase of certain property and equipment of \$213,172. Cash flows from financing activities consisted of proceeds from the exercise of stock options of \$424,336.

Based upon our financial performance in fiscal 2006, we believe our \$24,735,200 in cash and available for sale securities at August 31, 2006, together with the funds generated from operations, will be sufficient to fund our working capital and capital resources needs for at least the next 12 months.

On July 15, 2004 TherMatrx, Inc. was sold to American Medical Systems Holdings, Inc. (AMS). Our part of the total proceeds from this sale was 25%. A portion of the payout from the sale was based on contingency payments. By the close of our fiscal year for 2006 we had received the last of the contingency payments from the TherMatrx sale. The total payout to us, including contingency payments, was approximately \$33.5 million.

We expect to incur additional expenses related to the commercial introduction of our BSD-2000 and MicroThermx systems, which will precede any revenue from the sale of such systems. We project that our sales and marketing

29

expenses in fiscal 2007 will be consistent with fiscal 2006 to support the commercial introduction of the BSD-2000 and MicroThermx systems.

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

The Company has no off balance sheet arrangements as August 31, 2006.

FORWARD-LOOKING STATEMENTS

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With the exception of historical facts, the statements contained in sections entitled "Management's Discussion and Analysis or Plan of Operation" and "Business" 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 commercial introduction of the BSD-2000 and MicroThermx systems;
 - o our expectations that in a higher production environment of established commercial sales we could achieve a 60% gross margin on system sales and 80% gross margin on service agreements and disposable applicators used with our MicroThermx 100 system;
 - o our expectations and efforts regarding FDA approvals relating to the BSD-2000 and MicroThermx systems;
 - o our belief that FDA approval for the BSD-2000 system would greatly contribute to our sales efforts;
 - o our development or acquisition of new technologies;
 - o our belief that our technology has application for numerous other medical purposes;
 - o the amount of expenses we will incur for the commercial introduction of the BSD-2000 and MicroThermx systems;
- 30
- o the expectation that our need present and future sales and marketing forces will expand;
 - o our belief that we can acquire materials and parts from multiple sources on a timely basis;
 - o our belief that our current working capital and cash from operations will be sufficient to fund our working capital and capital resources needs for fiscal 2006; and
 - o our belief that we can cover any cash shortfall with cost cutting or available cash.

We wish to caution readers that the forward-looking statements and our operating results are subject to various risks and uncertainties that could cause our actual results and outcomes to differ materially from those discussed or anticipated, including the factors set forth in the section entitled "Risk Factors" included elsewhere in this report. 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

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or expectations, other than as required by law.

ITEM 7. FINANCIAL STATEMENTS

BSD MEDICAL CORPORATION

Financial Statements

As of August 31, 2006 and for the Years Ended August 31, 2006 and 2005

Together with Report of Independent Registered Public Accounting Firm

31

BSD MEDICAL CORPORATION
Index to Financial Statements

| | Page |
|---|------|
| Report of Independent Registered Public Accounting Firm | F-1 |
| Balance Sheet | F-2 |
| Statements of Income | F-3 |
| Statements of Stockholders' Equity | F-4 |
| Statements of Cash Flows | F-5 |
| Notes to Financial Statements | F-6 |

REPORT OF INDEPENDENT REGISTERED
PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
of BSD Medical Corporation

We have audited the accompanying balance sheet of BSD Medical Corporation (the

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Company) as of August 31, 2006, and the related statements of income, stockholders' equity, and cash flows for the years ended August 31, 2006 and 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of BSD Medical Corporation as of August 31, 2006, and the results of its operations and its cash flows for the years ended August 31, 2006 and 2005 in conformity with U.S. generally accepted accounting principles.

Salt Lake City, Utah
November 29, 2006

F-1

BSD MEDICAL CORPORATION
Balance Sheet

August 31, 2006

| | |
|--|--------------|
| ----- | |
| Assets | |
| ----- | |
| Current assets: | |
| Cash and cash equivalents | \$ 2,179,094 |
| Investments | 22,556,106 |
| Receivables, net of allowance for doubtful accounts of \$20,000 | 1,186,800 |
| Related party trade receivables | 261,543 |
| Inventories, net | 1,366,264 |
| Deferred tax asset | 178,000 |
| Other current assets | 120,277 |
| | ----- |
| Total current assets | 27,848,084 |
| Property and equipment, net | 303,034 |
| Note receivable | 137,500 |
| Patent, net of amortization of \$10,678 | 21,250 |
| | ----- |

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\$ 28,309,868

 Liabilities and Stockholders' Equity

| | |
|--|---------------|
| Current liabilities: | |
| Accounts payable | \$ 365,396 |
| Accrued liabilities | 545,113 |
| Income taxes payable | 1,539,946 |
| Deferred revenue - current portion | 17,912 |
| | ----- |
| Total current liabilities | 2,468,367 |
| | ----- |
| Deferred revenue - less current portion | 217,500 |
| | ----- |
| Commitments and contingencies | |
| Stockholders' equity: | |
| Preferred stock, \$.001 par value; 10,000,000 authorized, no shares issued and outstanding | - |
| Common stock, \$.001 par value; 40,000,000 shares authorized; 21,023,668 shares issued and outstanding | 21,024 |
| Additional paid-in capital | 25,452,231 |
| Deferred compensation | (247,700) |
| Treasury stock, at cost | (234) |
| Other comprehensive loss | (99,362) |
| Retained earnings | 498,042 |
| | ----- |
| Total stockholders' equity | 25,624,001 |
| | ----- |
| | \$ 28,309,868 |
| | ----- |

See accompanying notes to financial statements.

F-2

BSD MEDICAL CORPORATION
 Statements of Income

Years Ended August 31,

| | 2006 | 2005 |
|--------------------------|--------------|--------------|
| | ----- | ----- |
| Revenues: | | |
| Sales | \$ 2,209,316 | \$ 1,033,632 |
| Sales to related parties | 689,086 | 987,472 |
| | ----- | ----- |

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| | | |
|--------------------------------------|--------------|--------------|
| | 2,898,402 | 2,021,104 |
| ----- | | |
| Costs and expenses: | | |
| Cost of sales | 1,399,426 | 675,130 |
| Cost of sales to related parties | 317,214 | 644,980 |
| Research and development | 1,251,956 | 859,614 |
| Selling, general, and administrative | 5,028,957 | 2,135,076 |
| | | |
| | 7,997,553 | 4,314,800 |
| ----- | | |
| Operating loss | (5,099,151) | (2,293,696) |
| ----- | | |
| Other income (expense): | | |
| Gain on sale of equity interest | 18,016,272 | 6,551,087 |
| Interest income | 1,301,341 | 362,462 |
| Other | 240,034 | 4,839 |
| | | |
| | 19,557,647 | 6,918,388 |
| ----- | | |
| Income before income taxes | 14,458,496 | 4,624,692 |
| Income tax provision | (5,209,000) | (1,303,000) |
| ----- | | |
| Net income | \$ 9,249,496 | \$ 3,321,692 |
| ----- | | |
| Income per common share - basic | \$ 0.45 | \$ 0.16 |
| ----- | | |
| Income per common share - diluted | \$ 0.42 | \$ 0.15 |
| ----- | | |
| Weighted average shares - basic | 20,766,000 | 20,198,000 |
| ----- | | |
| Weighted average shares - diluted | 22,174,000 | 21,453,000 |
| ----- | | |

See accompanying notes to financial statements.

F-3

Stat
Years

Other Com- (Accumulated

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| | Common Stock | | Additional Paid-in Capital | Deferred Compen- sation | prehensive Income (loss) | Deficit) Retained Earnings |
|---|--------------|-----------|----------------------------------|-------------------------------|--------------------------------|----------------------------------|
| | Shares | Amount | | | | |
| Balance, September 1, 2004 | 19,945,982 | \$ 19,946 | \$ 23,201,020 | \$ (27,808) | \$ - | \$ (12,073,146) |
| Common stock issued for: | | | | | | |
| Cash | 391,188 | 391 | 74,914 | - | - | - |
| Services | 27,900 | 28 | 44,972 | - | - | - |
| Stock options issued for services | - | - | 96,500 | - | - | - |
| Income tax benefit from exercise of stock options | - | - | 272,945 | - | - | - |
| Amortization of deferred compensation | - | - | - | 9,508 | - | - |
| Increase in other comprehensive income | - | - | - | - | 36,939 | - |
| Deferred compensation | - | - | 15,750 | (15,750) | - | - |
| Net income | - | - | - | - | - | 3,321,692 |
| Balance August 31, 2005 | 20,365,070 | 20,365 | 23,706,101 | (34,050) | 36,939 | (8,751,454) |
| Common stock issued for: | | | | | | |
| Cash | 644,991 | 645 | 423,691 | - | - | - |
| Services | 13,607 | 14 | 48,457 | - | - | - |
| Income tax benefit from exercise of stock options | - | - | 972,282 | - | - | - |
| Amortization of deferred compensation | - | - | - | 88,050 | - | - |
| Decrease in other comprehensive income | - | - | - | - | (136,301) | - |
| Deferred compensation | - | - | 301,700 | (301,700) | - | - |
| Net income | - | - | - | - | - | 9,249,496 |
| Balance, August 31, 2006 | 21,023,668 | \$ 21,024 | \$ 25,452,231 | \$ (247,700) | \$ (99,362) | \$ 498,042 |

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See accompanying notes to financial statements

BSD MEDICAL CORPORATION Statements of Cash Flows

Years Ended August 31,

| | 2006 | 2005 |
|---|---|--------------|
| <hr style="border-top: 1px dashed black;"/> | | |
| Cash flows from operating activities: | | |
| Net income | \$ 9,249,496 | \$ 3,321,692 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Provision for doubtful accounts | (22,500) | 42,500 |
| Depreciation and amortization | 86,860 | 76,991 |
| Gain on sale of investment in TherMatrix | (18,016,272) | (6,551,087) |
| Gain on sale of property | - | (1,050) |
| Amortization of deferred compensation | 88,050 | 9,508 |
| Stock issued for services | 48,471 | 141,500 |
| Decrease (Increase) in: | | |
| Receivables | (922,163) | (286,876) |
| Note receivable | (137,500) | - |
| Inventories | (231,911) | (393,937) |
| Deferred tax asset | (74,000) | 725,000 |
| Other current assets | 12,464 | (81,675) |
| Increase (decrease) in: | | |
| Accounts payable | 252,583 | 13,682 |
| Income tax payable | 2,271,469 | 513,704 |
| Accrued liabilities | 296,737 | (175,539) |
| Deferred revenue | 228,084 | (39,895) |
| Deferred tax liability | (13,000) | (38,000) |
| | <hr style="border-top: 1px dashed black;"/> | |
| Net cash used in operating activities | (6,883,132) | (2,723,482) |
| <hr style="border-top: 1px dashed black;"/> | | |
| Cash flows from investing activities: | | |
| Proceeds from sale of investment in TherMatrix | 18,016,272 | 6,551,087 |
| Purchase of investments | (10,073,884) | (12,581,584) |
| Proceeds from sale of property | - | 1,050 |
| Purchase of property and equipment | (213,172) | (110,856) |
| | <hr style="border-top: 1px dashed black;"/> | |
| Net cash provided by (used in) investing activities | 7,729,216 | (6,140,303) |
| <hr style="border-top: 1px dashed black;"/> | | |
| Cash flows from financing activities- | | |
| proceeds from issuance of common stock | 424,336 | 75,305 |
| <hr style="border-top: 1px dashed black;"/> | | |
| Increase (decrease) in cash and cash equivalents | 1,270,420 | (8,788,480) |
| Cash and cash equivalents, beginning of year | 908,674 | 9,697,154 |

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| | | | | |
|--|----|-----------|----|---------|
| Cash and cash equivalents, end of year | \$ | 2,179,094 | \$ | 908,674 |
|--|----|-----------|----|---------|

See accompanying notes to financial statements.

F-5

BSD MEDICAL CORPORATION
Notes to Financial Statements

1. Organization and Significant Accounting Policies

Organization

BSD Medical Corporation (the Company) was incorporated in the State of Delaware on July 3, 1986. The Company develops, produces, markets, and services systems used for the treatment of cancer and other diseases. These systems are sold worldwide. In addition, the Company held an interest in TherMatrx until July 15, 2004. On July 15, 2004, TherMatrx, Inc. was sold to American Medical Systems Holdings, Inc. (AMS). The Company's part of the total proceeds from this sale was approximately 25%. A portion of the payout from the sale was based on contingency payments. By the close fiscal year 2006 the Company had received the last of the contingency payments from the TherMatrx sale. The total payout to the Company, including contingency payments, was approximately \$33.5 million.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and investments with original maturities to the Company of three months or less.

Investments

Investment with scheduled maturities greater than three months, but not greater than one year, are recorded as short-term investments. Management classified these investments at August 31, 2006 as available-for sale. The short-term investments are recorded at fair value, with net unrealized gains and losses reported as other comprehensive income in the statements of stockholders' equity. Realized gains and losses are included in the statements of income.

Trade Accounts Receivable

Trade accounts receivable are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management estimates an allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Trade accounts receivable are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received. Interest is not charged on trade receivables that are outstanding beyond their due date.

BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

1. Organization and Significant Accounting Policies Continued

Inventories

Parts and supplies inventories are stated at the lower of cost or market. Cost is determined using the average cost method. Work-in-process and finished goods are stated at the lower of the accumulated manufacturing costs or market. Provisions, when required, are made to reduce excess and obsolete inventories to their estimated net realizable value. The provision was \$40,000 at August 31, 2006.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation and amortization are determined using the straight-line method over the following estimated useful lives of the assets.

| | |
|------------------------|-----------|
| Equipment | 2-5 years |
| Furniture and fixtures | 5 years |
| Leasehold improvements | 10 years |

Leasehold improvements are depreciated over the shorter of their estimated useful life or the remaining term of the lease. Expenditures for maintenance and repairs are expensed when incurred and betterments are capitalized. Gains and losses on sales of property and equipment are reflected in operations.

Investment in Joint Venture

The Company had an ownership interest in TherMatrx, a corporate joint venture that is engaged in the manufacture and sale of medical devices. The investment was accounted for on the equity method of accounting. Because the Company's percent share of accumulated losses in TherMatrx had exceeded its original investment no asset was recorded on the balance sheet. On July 15, 2004 TherMatrx, Inc. was sold to American Medical Systems Holdings, Inc. (AMS). The Company's part of the total proceeds from this sale was approximately 25%. A portion of the payout from the sale was based on contingency payments. By the close of fiscal year 2006 the Company had received the last of the contingency payments from the TherMatrx sale. The total payout to the Company, including contingency payments, was approximately \$33.5 million.

Patents

Patents are carried at cost and are being amortized over 17 years.

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BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

1. Organization and Significant Accounting Policies Continued

Warranty Reserve

The Company provides limited warranties to its customers for products sold. Estimated future warranty obligations are accrued each period. As of August 31, 2006, the accrued warranty reserve was approximately \$31,000. During the fiscal years ended August 31, 2006 and 2005, total warranty expense was \$24,763 and \$21,662, respectively.

Income Taxes

The Company accounts 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 tax 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.

Income Per Common Share

The computation of basic income (loss) per common share is based on the weighted average number of shares outstanding during each year.

The computation of diluted earnings per common share is based on the weighted average number of shares outstanding during the year, plus the common stock equivalents that would arise from the exercise of stock options and warrants outstanding, using the treasury stock method and the average market price per share during the year. Common stock equivalents are not included in the diluted loss per share calculation when their effect is anti-dilutive. Options and warrants to purchase 1,809,051 and 2,122,934 shares of common stock at prices ranging from \$.37 to \$5.76 and \$.10 to \$2.54 per share were outstanding at August 31, 2006 and 2005, respectively.

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

| | 2006 | 2005 |
|---|------------|------------|
| Weighted average number of shares outstanding - basic | 20,766,000 | 20,198,000 |
| Dilutive effect of stock options | 1,408,000 | 1,255,000 |
| | | |

Weighted average number

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of shares outstanding,
 assuming dilution 22,174,000 21,453,000

F-8

BSD MEDICAL CORPORATION
 Notes to Financial Statements
 Continued

1. Organization and Significant Accounting Policies Continued Stock-Based Compensation

The Company accounts for stock options granted to employees under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations, and has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation". Accordingly, compensation costs are recognized in the financial statements for options granted with an exercise price less than the market value of the underlying common stock on the date of grant. During the years ended August 31, 2006 and 2005, the Company recognized \$88,050 and \$9,508, respectively, related to stock options granted to employees with an exercise price less than the market value of the underlying common stock. Had the Company's options been determined based on the fair value method, the results of operations would have been reduced to the pro forma amounts indicated below:

| | Years Ended August 31, | |
|---|------------------------|--------------|
| | 2006 | 2005 |
| Net income - as reported | \$ 9,249,496 | \$ 3,321,692 |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects | 88,050 | 9,508 |
| Deduct: total stock based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (749,586) | (504,839) |
| Net income - pro forma | \$ 8,587,960 | \$ 2,826,361 |
| Earnings per share: | | |
| Basic - as reported | \$.45 | \$.16 |
| Basic - pro forma | \$.41 | \$.14 |
| Diluted - as reported | \$.42 | \$.15 |
| Diluted - pro forma | \$.39 | \$.13 |

BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

1. Organization of Significant Accounting Policies Continued

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

| | 2006 | 2005 |
|---------------------------------|-------------|-------------|
| Expected dividend yield | \$ - | \$ - |
| Expected stock price volatility | 68% - 76% | 71% - 83% |
| Risk-free interest rate | 4.0% - 5.0% | 3.3% - 4.1% |
| Expected life of options | 3 - 5 years | 3 - 5 years |

The weighted average fair value of options granted during the years ended August 31, 2006 and 2005 were \$3.50 and \$1.97, respectively.

Revenue Recognition

The Company recognizes revenue from the sale of cancer treatment systems, the sale of parts and accessories related to the cancer treatment systems, the sale of software license rights, providing manufacturing services, providing training, and service support contracts. Product sales were \$ 2,706,214 and \$1,844,321 for the years ended August 31, 2006 and 2005, respectively. Service revenue was \$192,188 and \$176,783 for the years ended August 31, 2006 and 2005, respectively.

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 the Company's cancer treatment systems do not require specific customer acceptance provisions and do not include the right of

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return except in cases where the product does not function as guaranteed by the Company. The Company provides a reserve allowance for estimated returns. To date, returns have not been significant.

F-10

BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

1. Organization of Significant Accounting Policies Continued

Revenue Recognition - Continued

Revenue from the sale of software license rights is recognized when a valid purchase order has been received, the software license has been delivered to the customer, the selling price is fixed or determinable, and collection is reasonably assured. Delivery is deemed to have occurred if diskettes have been shipped, or if the software has been delivered electronically by email. To date, the sale of software license rights has not been material.

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, which approximates recognizing it as it is earned.

The Company's revenue recognition policy is the same for sales to both related parties and non-related parties. The Company provides the same products and services under the same terms for non-related parties as with related parties.

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

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

F-11

BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

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1. Organization of Significant Accounting Policies Continued

Concentration of Credit Risk
Financial instruments that potentially subject the Company to concentration of credit risk consists primarily of trade receivables. In the normal course of business, the Company provides credit terms to its customers. Accordingly, the Company performs ongoing credit evaluations of its customers and maintains allowances for possible losses.

The Company has cash in the bank and short-term investments that exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on cash and short-term investments.

Advertising and Promotion
Advertising and promotion costs, which are principally included in sales expenses, are expensed as incurred. Advertising and promotion expense was approximately \$758,000 and \$103,000 for the years ended August 31, 2006 and 2005, respectively.

Use of Estimates in the Preparation of Financial Statements
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Comprehensive Income (loss)
Comprehensive income (loss) consists of net income and net unrealized gains and losses from the Company's investments classified as available-for sale, which is reported on the accompanying statements of stockholders' equity as a component of other comprehensive income.

Reclassifications
Certain amounts in the prior year have been reclassified to conform with the current year presentation.

F-12

BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

2. Detail of Certain Balance Sheet Accounts

Details of certain balance sheet accounts as of August 31, 2006, are as follows:

Receivables:

Table with 2 columns: Description and Amount. Trade receivables - non-related party \$ 1,076,006; Other receivables 8,000

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| | |
|--------------------------------------|----------|
| Accrued interest receivable | 122,794 |
| Less allowance for doubtful accounts | (20,000) |

\$ 1,186,800

Inventories:

| | |
|--------------------------------|------------|
| Parts and supplies | \$ 711,552 |
| Work-in-process | 641,608 |
| Finished goods | 53,104 |
| Reserve for obsolete inventory | (40,000) |

\$ 1,366,264

Accrued liabilities:

| | |
|------------------------|------------|
| Accrued vacation | \$ 192,203 |
| Accrued taxes payable | 60,311 |
| Customer deposits | 100,000 |
| Other accrued expenses | 192,599 |

\$ 545,113

3. Investments

As of August 31, 2006, investments consist of mutual funds. All investments at August 31, 2006 were considered available-for-sale securities. As of August 31, 2006, investments had a cost of \$22,655,468, fair value of \$22,556,106 and unrealized losses of \$99,362. As of August 31, 2005, investments had a cost of \$12,581,584, fair value of \$12,618,523 and unrealized gains of \$36,939. No realized gains or losses on investments were recorded in the years ended August 31, 2006 and 2005.

F-13

BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

4. Property and Equipment

Property and equipment consists of the following:

| | |
|------------------------|------------|
| Equipment | \$ 997,053 |
| Furniture and fixtures | 298,597 |
| Leasehold improvements | 17,420 |

1,313,070

| | |
|-------------------------------|-------------|
| Less accumulated depreciation | (1,010,036) |
|-------------------------------|-------------|

\$ 303,034

Depreciation expense for the years ended August 31, 2006 and 2005 totaled \$84,982 and \$75,113, respectively.

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5. Note Receivable During the year ended August 31, 2006, the Company entered into a sales agreement with one of its customers with extended payment terms. These terms allowed for \$137,500 of the purchase price to be due within two years from the date of the sale. Accordingly, this amount has been recorded as non-current and interest imputed on the amount calculated at market rates.

6. Patent The Company has one patent recorded net of accumulated amortization. The patent is being amortized on a straight-line basis over its estimated useful life with an amortization period of 17 years. Amortization expense was \$1,878 for each of the years ended August 31, 2006 and 2005. For each of the next five years, amortization expense relating to the patent is expected to be \$1,878 per year.

F-14

BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

7. Operating Lease The Company renewed its building lease in November of 2002 for five years, which includes payments of approximately \$82,000 per year, adjusted annually for increases in the cost of living based on the Consumer Price Index for Urban Consumers.

Future minimum lease payments at August 31, 2006, are as follows:

| Years Ending August 31, | Amount |
|-------------------------|------------|
| 2007 | \$ 92,174 |
| 2008 | 23,213 |
| | ----- |
| | \$ 115,387 |
| | ----- |

Annual rent expense on this operating lease for the years ended August 31, 2006 and 2005 amounted to \$ 89,393 and \$86,400, respectively.

8. Deferred Revenue The Company has entered into certain service contracts for which it has received payment in advance. The Company is recognizing these service revenues over the life of the service agreements.

As of August 31, 2006, the Company had \$235,412 of deferred revenue.

9. Major Customers The Company had the following customer revenue concentrations for the years ended August 31, 2006 and 2005:

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| | 2006 | 2005 |
|------------|--------|--------|
| Customer A | 45.48% | 29.84% |
| Customer B | 23.77% | 48.55% |
| Customer C | 10.38% | * |

*Sales to customers were less than 10%.

F-15

BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

10. Income Taxes The components of the income tax (provision) benefit are as follows:

| | Years Ended August 31, | |
|-----------|------------------------|----------------|
| Current: | | |
| Federal | \$ (4,606,000) | \$ (452,000) |
| State | (690,000) | (164,000) |
| | (5,296,000) | (616,000) |
| Deferred: | | |
| Federal | 87,000 | (687,000) |
| | \$ (5,209,000) | \$ (1,303,000) |

The income tax (provision) benefit differs from the amount computed at federal statutory rates as follows:

| | Years Ended August 31, | |
|---|------------------------|----------------|
| | 2006 | 2005 |
| Income tax benefit (expense) at statutory rate | \$ (5,393,000) | \$ (1,711,000) |
| Change in estimate of use of net operating loss carryforwards | - | 284,000 |
| Research and development tax credits | 190,000 | 76,000 |
| Other | (6,000) | 48,000 |
| | \$ (5,209,000) | \$ (1,303,000) |

Deferred tax assets (liabilities) are comprised of the following at August 31, 2006:

| | |
|-----------------------|-----------|
| Accruals and reserves | \$ 96,000 |
|-----------------------|-----------|

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| | |
|-------------------------------|------------|
| Deferred revenue | 80,000 |
| Depreciation | (55,000) |
| Deferred compensation expense | 57,000 |
| | ----- |
| | \$ 178,000 |
| | ----- |

F-16

BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

11. Stock
Options and
Warrants

Stock Options

The Company's 1987 Employee Stock Option Plan authorizes the granting of incentive options to certain key employees of the Company and nonqualified stock options to certain key employees, non-employee directors, or individuals who provide services to the Company. The Plan, as amended, provides for the granting of options for an aggregate of 950,000 shares. The options vest according to a set schedule over a five-year period and expire upon the employee's termination or after ten years from the date of grant.

The Company's 1988 Employee Stock Option Plan authorizes the granting of incentive stock options to certain key employees and non-employees who provide services to the Company. The Plan provides for the granting of options for an aggregate of 2,000,000 shares. The options vest subject to management's discretion.

The Company's 1998 Director Stock Plan was amended in February of 2006 to provide an annual retainer of \$30,000 to each non-employee director with the exception of the Audit Committee Chairman who is to receive \$35,000. The annual compensation plan calls for payment to be made twice a year with each payment consisting of \$15,000 in cash and \$15,000 in common stock, with the exception of the Audit Committee Chairman who is to receive \$20,000 in cash and \$15,000 in common stock with the number of shares issued calculated by dividing the unpaid compensation by a daily average of the preceding twenty day closing price of the Company's common stock. The Plan also grants each non-employee outside director 30,000 options each year at an exercise price of the fair market value of the common stock at the date the option is granted. The Plan allows for an aggregate of 1,000,000 shares to be granted. The options vest according to a set schedule over a five-year period and expire upon the director's termination, or after ten years from the date of grant. For certain options issued under this plan, the Company has recorded as deferred compensation the excess of the market value of common stock at the date of grant over the exercise price.

F-17

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BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

11. Stock Options and Warrants Continued

A schedule of the options and warrants is as follows:

| | Options | Warrants | Price Per Share |
|----------------------------------|-----------|-----------|-----------------|
| Outstanding at September 1, 2004 | 2,334,553 | 102,980 | \$.10 to 2.54 |
| Granted | 225,000 | - | 1.20 to 2.54 |
| Exercised | (401,619) | - | .10 to .66 |
| Forfeitures | (35,000) | - | .10 |
| Outstanding at August 31, 2005 | 2,122,934 | 102,980 | .10 to 2.54 |
| Granted | 364,368 | - | 2.44 to 5.76 |
| Exercised | (588,251) | (102,980) | .10 to .254 |
| Forfeitures | (90,000) | - | .54 to 4.92 |
| Outstanding at August 31, 2006 | 1,809,051 | - | \$.37 to 5.76 |

The following table summarizes information about stock options and warrants outstanding at August 31, 2006:

| Range of Exercise Prices | Options and Warrants Outstanding | | | Options and Warrants Outstanding | | |
|--------------------------|----------------------------------|---|---------------------------------|----------------------------------|---------------------------------|--|
| | Number Outstanding | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Number Exercisable | Weighted Average Exercise Price | |
| \$.37-81 | 411,348 | 3.86 | \$.65 | 393,230 | \$.65 | |
| 1.11-2.74 | 1,168,335 | 7.83 | 1.44 | 808,827 | 1.31 | |
| 2.75-5.76 | 229,368 | 9.42 | 5.14 | 26,820 | 5.11 | |
| \$.37-5.76 | 1,809,051 | 7.13 | \$ 1.72 | 1,228,877 | \$ 1.18 | |

12. Foreign Customer and Major Customer

During the years ended August 31, 2006 and 2005, the Company had sales to a European entity controlled by a significant stockholder and member of the Board of Directors of the Company of \$689,086 and \$987,472 respectively.

F-18

BSD MEDICAL CORPORATION

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Notes to Financial Statements
Continued

13. Related Party Transactions Not otherwise disclosed At August 31, 2006, accounts receivable includes \$261,543 due from an entity controlled by a significant stockholder and member of the Board of Directors.

14. Supplemental Cash Flow Information Actual amounts paid for interest and income taxes are as follows:

| | Years Ended August 31, | | | |
|------------------|---------------------------|-----------|----|---------|
| Interest expense | \$ | - | \$ | - |
| Income taxes | \$ | 2,576,605 | \$ | 351,354 |

During the year ended August 31, 2006, the Company:

- o Had other comprehensive loss of \$136,301.
- o Recorded deferred compensation of \$301,700.
- o Recorded an increase in additional paid in capital of \$972,282 and corresponding decrease to income taxes payable related to the tax benefit from the exercise of stock options.

During the year ended August 31, 2005, the Company:

- o Had other comprehensive income of \$36,939.
- o Recorded deferred compensation of \$15,750.
- o Recorded an increase in additional paid in capital of \$272,945 and a corresponding decrease to income taxes payable related to the tax benefit from the exercise of stock options.

F-19

BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

15. Commitments and Contingencies The Company has an employment agreement with the President of the Company. The agreement provides that the President's salary will be based upon a reasonable mutual agreement. Additionally, in the case of non-voluntary termination, the acting president will receive severance pay for a six-month period, which includes an extension of all employee rights, privileges, and benefits, including medical insurance. The six-month severance pay would be the salary at the highest rate paid to the

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president prior to such a non-voluntary termination. The agreement also requires the Company to pay the acting president for any accrued unused vacation and bonuses.

The Company has an exclusive worldwide license for a unique temperature probe. The license has no determinable life. The Company pays royalties based upon its sales of this probe. There was approximately \$3,500 in accrued royalties as of August 31, 2006. Royalty expense amounted to approximately \$6,180 and \$4,710 for the years ended August 31, 2006 and 2005, respectively.

16. Fair Value of
Financial
Instruments

None of the Company's financial instruments are held for trading purposes. The Company estimates that the fair value of all financial instruments at August 31, 2006 and 2005 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying balance sheet. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. Considerable judgment is necessarily required in interpreting market data to develop the estimates of fair value, and, accordingly, the estimates are not necessarily indicative of the amounts that the Company could realize in a current market exchange.

F-20

BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

17. Recent
Accounting
Pronounce-
ments

In December 2004, the Financial Accounting Standards Board ("FASB") issued Financial Accounting Standard ("SFAS") No. 123(R), Share-Based Payment, an amendment of FASB Statements No. 123 and 95. SFAS No. 123(R) replaces SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. This statement requires companies to recognize the fair value of stock options and other stock-based compensation to employees prospectively beginning with fiscal periods beginning after December 15, 2005. This means that the Company will be required to implement SFAS No. 123(R) no later than the quarter beginning September 1, 2006. The Company currently measures stock-based compensation in accordance with APB Opinion No. 25 as discussed above. The Company anticipates adopting the modified prospective method of SFAS No. 123(R) on September 1, 2006. The impact on the Company's financial condition or results of operations will depend on the number and terms of stock options outstanding on the date of change, as well as future options that may be granted. However, the Company believes the adoption of SFAS No. 123(R) may have a material effect on the Company's financial position and results of operations.

The FASB has issued Statement No. 154, Accounting Changes

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and Error Corrections. This new standard replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements. Among other changes, SFAS No. 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle, unless it is impracticable to do so. SFAS No. 154 also provides that (1) a change in method of depreciating or amortizing a long-lived nonfinancial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and (2) correction of errors in previously issued financial statements should be termed a "restatement." The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. Early adoption of this standard is permitted for accounting changes and correction of errors made in fiscal years beginning after June 1, 2005. The Company anticipates adopting SFAS No. 154 on September 1, 2006, and does not believe the adoption of this new accounting pronouncement will result in a material impact on the Company's financial position or results of operations.

F-21

BSD MEDICAL CORPORATION
Notes to Financial Statements
Continued

17. Recent
Accounting
Pronounce-
ments
Continued

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

In September 2006, the FASB issued SFAS No. 157, entitled 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 [level 3], including a reconciliation of the beginning and ending balances separately for each major

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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.

F-22

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND

FINANCIAL DISCLOSURE

None.

ITEM 8A. 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, as of the end of the period covered by this report, our disclosure controls and procedures were effective.

During the fourth fiscal quarter, 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.

ITEM 8B. OTHER INFORMATION

None.

32

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS;

COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

The following table sets forth certain information concerning our directors, executive officers and key employees. The directors have served in their respective capacities since their election and/or appointment and will serve until the next annual stockholders' meeting or until a successor is duly elected, unless the office is vacated in accordance with our certificate of incorporation or bylaws. The executive officers serve at the pleasure of the Board of Directors. There are no family relationships among any of our directors or officers.

| Name | Age | Position |
|------|-----|----------|
|------|-----|----------|

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| | | |
|-----------------------------|----|--|
| Paul F. Turner, MSEE(1) | 59 | Chairman of the Board, Senior Vice President, and Chief Technology Officer |
| Hyrum A. Mead, MBA(1) | 59 | President and Member of the Board of Directors |
| Gerhard W. Sennewald, Ph.D. | 70 | Member of the Board of Directors |
| Michael Nobel, Ph.D. | 66 | Member of the Board of Directors |
| Douglas P. Boyd, Ph.D. | 65 | Member of the Board of Directors |
| Steven G. Stewart | 58 | Member of the Board of Directors |

(1) Executive officers of BSD.

Paul F. Turner, MSEE, has served as a director of BSD since 1994 and currently serves as Chairman of the Board of Directors. Mr. Turner also has served as the Senior Vice President and Chief Technology Officer of BSD since August 1999. From October 1995 to August 1999, Mr. Turner also served as the Acting President of BSD. From 1986 to October 1995, Mr. Turner served in various capacities with BSD, including Staff Scientist, Senior Scientist, Vice President of Research, and Senior Vice President of Research. Mr. Turner has led the design of microwave treatment systems for tumors, including the development of external phased array antenna technology to focus radiated microwave energy deep into the central area of the body to treat deep tumors. He has also integrated this novel technology with magnetic resonance imaging to non-invasively monitor treatments within the patient's body.

Hyrum A. Mead, MBA, has served as President and a director of BSD since August 1999. Previously, he served five years as Vice President of Business Development at ZERO Enclosures, a leading manufacturer in the telecommunications, computer and aerospace enclosures industry and seven years as President of Electro Controls, a manufacturer of computer controlled power systems. Mr. Mead began his career in marketing with IBM where he was involved with the introduction of many new products.

33

Gerhard W. Sennewald, Ph.D., has served as a director of BSD since 1994. Dr. Sennewald has served as the President and Chief Executive Officer of Medizin-Technik GmbH, of Munich, Germany, a firm which is engaged in the business of distributing hyperthermia equipment and diagnostic imaging equipment and services, from April 1985 to the present. In connection with his service to Medizin-Technik GmbH, Dr. Sennewald has been BSD's key European representative and distributor for 17 years and has been instrumental in obtaining the majority of BSD's foreign sales. He also serves on the Board of Directors of TherMatrx, Inc.

Michael Nobel, Ph.D., has served as a director of BSD since January 1998. From 1991 to the present, Dr. Nobel has served as the Executive Chairman of the MRAB Group, a privately-held company that provides diagnostic imaging services. From 1995 to the present, Dr. Nobel has served as the Chairman of the Board of the Nobel Family Society. From 1995 to the present, he also has served as Chairman of the American Non-Violence Project Inc., and has served as a consultant to Unesco in Paris and the United Nations Social Affairs Division in Geneva. Dr. Nobel participated in the introduction of magnetic resonance imaging as European Vice President for Fonar Corp.

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Douglas P. Boyd, Ph.D. currently serves as Chairman of the Board of XLR Medical, Inc., as CEO of TeleSecurity Sciences, Inc., as Managing Director of Imaging Technology Ventures, Inc., and on the Board of Directors of Imaging Technology Group, Inc., TechniScan, Inc. and Health Address, Inc. He is internationally known as an expert in radiology and computed tomography ("CT") imaging systems, and has pioneered the development of fan-beam CT scanners, Xenon detector arrays and EBT scanners. Dr. Boyd has been awarded 13 U.S. patents. He is an Adjunct Professor of Radiology at the University of California, San Francisco, has published more than 100 scientific papers and is a frequent speaker at universities and symposia.

Steven G. Stewart, CPA, served as Chief Financial Officer for Headwaters, Inc. (a New York Stock Exchange Company) from July 1998 until October 2005 when he became the Treasurer and subsequently the Director of Financial Affairs. Previously, Mr. Stewart served as a business assurance partner for PricewaterhouseCoopers LLP (formerly Coopers & Lybrand LLP), and as an audit partner with Ernst & Young (formerly Arthur Young), including service as the Salt Lake City office Director of High Technology and Entrepreneurial Services. Mr. Stewart's involvement with Headwaters is part-time now and will be through March 2009 when he will fully retire from Headwaters.

Section 16(a) of the Securities Act of 1934 requires our directors, executive officers, and any persons who own more than 10% of a registered class of our equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission. SEC regulation requires executive officers, directors and greater than 10% stockholders to furnish us with copies of all Section 16(a) forms they file. Based solely on our review of the copies of such forms received by us, or written representations from certain reporting persons, we believe that during the fiscal year ended August 31, 2006 our executive officers, directors, and greater than 10% stockholders complied with all applicable filing requirements.

34

COMPOSITION OF THE BOARD

The Board of Directors of the Company currently consists of six directors. Directors are elected at each annual meeting of stockholders to serve until the next annual meeting of stockholders or until their successors are duly elected and qualified. There are no family relationships among any of the Company's directors, officers or key employees.

Affirmative Determinations Regarding Director Independence

The Board of Directors has determined each of the following directors to be an "independent director" as such term is defined in Section 121A of the Rules of the American Stock Exchange:

Douglas P. Boyd
Steven G. Stewart
Michael Nobel

MEETINGS AND COMMITTEES OF THE BOARD OF DIRECTORS

During fiscal year 2006, the Company's Board of Directors met four times and no director attended fewer than 75% of meetings of the Board or any of the Board committees of which a director was a member.

The Board of Directors has formed the following committees:

The Audit Committee. The Audit Committee, which held four meetings

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during fiscal year 2006, is responsible for reviewing and monitoring the Company's financial statements and internal accounting procedures, recommending the selection of independent auditors by the Board, evaluating the scope of the annual audit, reviewing audit results, consulting with management and the Company's independent auditor prior to presentation of financial statements to stockholders and, as appropriate, initiating inquiries into aspects of the Company's internal accounting controls and financial affairs. The Board of Directors has adopted a written audit committee charter.

The members of the Audit Committee are Messrs. Sennewald, Boyd, Stewart and Nobel. Mr. Stewart is currently serving as the audit committee chairman and financial expert. All members of the Audit Committee are independent directors, except Mr. Sennewald.

The Nominating Committee. The Company does not have a standing nominating committee. Each director participates in decisions relating to making the Company's nominations for directors. The Board of Directors believes that, considering the size of the Company and the Board of Directors, nominating decisions can be easily made on a case-by-case basis and there is no need for the added formality of a nominating committee. Based on criteria established by the American Stock Exchange relating to director independence, Messrs. Stewart, Boyd and Nobel are the Company's only independent directors.

The Board of Directors does not have an express policy with regard to the consideration of any director candidates since the Board believes that it can adequately evaluate nominees on a case-by-case basis. The Board has not previously received any recommendations for director candidates from

35

stockholders, and has not adopted a formal process for considering director candidates who may be recommended by stockholders. However, the Company's policy is to give due consideration to any and all such candidates, and in evaluating director nominees, the Board considers the appropriate size of the Board, the needs of the Company, the skills and experience of its directors, and a candidate's familiarity with the Company's industry. The Company does not pay fees to any third parties to assist it in identifying potential nominees.

Although the Company does not have a formal policy regarding attendance by directors at the Company's Annual Meeting, it encourages directors to attend. The Board will give consideration during the upcoming year to establishing a formal policy so as to maximize attendance by directors, taking into account the directors' schedules and the timing requirements of applicable law.

The Compensation Committee. The Company does not have a standing compensation committee. The independent directors of the Board act as a committee on compensation issues.

COMMUNICATIONS WITH DIRECTORS

The Company has not adopted a formal process for stockholder communications with the Board. Nevertheless, the Company has tried to ensure that the views of stockholders are heard by the Board or individual directors, as applicable, and that appropriate responses are provided to stockholders in a timely manner. The Company believes its responsiveness to stockholder communications to the Board has been good.

EXECUTIVE OFFICERS

The following table presents information as of August 31, 2006 regarding the current executive officers of the Company:

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| Name ----- | Age --- | Position ----- |
|----------------------|------------|---|
| Paul F. Turner, MSEE | 59 | Chairman of the Board, Senior VP and Chief Technology Officer |
| Hyrum A. Mead, MBA | 59 | President |

Information on the business background of Paul F. Turner and Hyrum A. Mead is set forth above under the caption "Election of Directors."

SIGNIFICANT EMPLOYEES

In addition to the officers and directors identified above, the Company expects the following individuals to make significant contributions to the Company's business during fiscal 2007:

| Name ----- | Age --- | Position ----- |
|---------------------|------------|--|
| Dixie Toolson Sells | 56 | Vice President of Regulatory Affairs |
| Ray Lauritzen | 56 | Vice President of Field Service |
| | 36 | |
| Brian L. Ferrand | 51 | Vice President of Sales |
| Richard A. White | 51 | Vice President of Business Development |

Dixie Toolson Sells has served as Vice President of Regulatory Affairs of BSD since December 1994. Ms. Sells served as Administrative Director of BSD from 1978 to 1984; as Director of Regulatory Affairs from 1984 to September 1987; and as Vice President of Regulatory Affairs from September 1987 to October 1993. In October 1993, Ms. Sells resigned as Vice President of Regulatory Affairs, and she served as Director of Regulatory Affairs from October 1993 to December 1994. In December 1994, Ms. Sells was re-appointed as Vice President of Regulatory Affairs and was appointed as Corporate Secretary by the Board of Directors. Ms. Sells also serves on the Board of Directors of the Intermountain Biomedical Association. Ms. Sells resigned as Corporate Secretary of BSD in March 2002.

Ray Lauritzen served as Field Service Manager of BSD from 1982 to January 1988 and has served as Vice President of Field Service Operations from January 1988 to the present.

Brian L. Ferrand, joined BSD Medical as Vice President of Sales in 2005. Previously, Mr. Ferrand served as Vice President of Sales and as a corporate officer of Merit Medical Systems, Inc. (a company traded on NASDAQ) from 1993 until October 2004. Previously Mr. Ferrand served as Director of Sales (1992-1993) and as a National Sales Manager (1991-1992) for Merit Medical. Merit Medical Systems is a producer of medical products used in Cardiology and Radiology sold on a worldwide basis.

Richard A. White, joined BSD Medical in 2004, and serves as Vice President of Business Development, looking for growth opportunities for the company, as well as overseeing the marketing and reimbursement efforts. Richard has been deeply involved in business development and growth since obtaining his degree in international business at The Garvin School of International Management "Thunderbird" in 1980. He has played a key role in the founding of new companies, has led a national sales organization selling large capital

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equipment in power control systems and served as International Sales Manager for Merit Medical Systems, a leading manufacturer and marketer of products used in diagnostic and interventional cardiology and radiology procedures.

CODE OF ETHICS

We have adopted a Code of Ethics that applies to all employees, including our principal executive officers. Our Code of Ethics is available on our website (www.bsdmc.com) on our investor information webpage. We intend to post amendments to or waivers from our Code of Ethics (to the extent applicable to our chief executive officer, principal financial officer or principal accounting officer) on our website.

37

ITEM 10. EXECUTIVE COMPENSATION

The following table sets forth certain information regarding all compensation earned by Paul Turner, our Senior Vice President and Chief Technology Officer, and Hyrum Mead, our President, for services rendered to us during fiscal 2006, 2005, and 2004.

SUMMARY COMPENSATION TABLE

| Name and Principal Position | Year | Annual Compensation | | Long-Term Compensation |
|---|------|---------------------|------------|----------------------------------|
| | | Salary (\$) | Bonus (\$) | Securities Underlying / SARs (#) |
| Paul Turner, Chairman of the Board, Senior Vice President, Chief Technology Officer | 2006 | \$172,160 | \$500 | 300,000 (1) |
| | 2005 | \$155,000 | \$500 | |
| | 2004 | \$149,990 | \$400 | |
| Hyrum A. Mead, President, Director | 2006 | \$181,660 | \$500 | 400,000 (1) |
| | 2005 | \$165,000 | \$500 | |
| | 2004 | \$148,325 | \$400 | |

(1) There were no stock options granted to Messrs. Turner or Mead in fiscal 2006 and 2005. There were stock options granted to Messrs. Turner of 300,000 and Mead of 400,000 during fiscal 2004 for BSD Medical Common Stock.

In fiscal 2006 Mr. Mead exercised 15,252 options and none were exercised by Mr. Turner. In fiscal 2005, Mr. Turner exercised 180,953 stock options and Mr. Mead exercised 25,000 stock options. No stock options were exercised during fiscal year 2004 by Messrs. Turner and Mead.

Paul F. Turner and Hyrum A. Mead are the only members of the Board of Directors who are employed by us. Messrs. Turner and Mead do not receive any separate compensation for services performed as directors.

COMPENSATION OF DIRECTORS

During fiscal 2006 we revised our 1998 Director Stock Option Plan to provide an annual retainer in the amount of \$30,000 to each non-employee

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director other than the Chair of the Audit Committee, who is to receive \$35,000. Of the Annual Retainer, a cash payment of \$15,000 is to be paid in cash and the balance is to be paid in the form of restricted shares of our common stock to each Non-Employee Director, other than the Chair of the Audit Committee, who is to receive a cash payment of \$20,000, payable in equal installments on March 1 and September 1 of each year in which each Non-Employee Director continues to serve as a member of the Board. The portion of the annual retainer that is paid in restricted stock will be determined by reference closing price for the Common Stock on the day of the payment. Each non-employee director will receive an annual option to purchase 30,000 restricted shares of our common stock at a purchase price calculated with respect to the Annual Retainer. The options vest ratably over 5 years and expire in 10 years.

38

For the period of September 1, 2003 through February 28, 2004 these directors were compensated with payments of \$5,000 in cash and issued common stock in the amount of 3,546 shares. For the period March 1, 2004 through August 31, 2004, the directors were paid \$5,000 in cash and issued 3,571 shares of common stock. For the period September 1, 2004 to February 28, 2005 the directors were compensated with payments of \$5,000 in cash and issued 2,183 shares of restricted common stock and for the period March 1, 2005 to August 31, 2005 they were issued \$5,000 in cash and 2,049 shares of restricted stock for their services with the exception of Douglas Boyd who was issued a prorated payment of \$3,050 in cash and 1,250 shares of common stock based on his start date on the Board of Directors of May 12, 2005. On September 20, 2005 these directors were issued a stock option grant of 25,000 shares based on a strike price of \$2.44 per share for their services for FYE 2006. On March 1, 2006 each non-employee director received a cash payment of \$7,500 and 1,531 shares of restricted stock for their services from September 1, 2005 to February 28, 2006, other than the Audit Committee Chair who received a pro-rated payment of \$2,659 in cash, 543 shares of restricted stock and a stock option grant of 16,368 shares at a strike price of \$5.76 per share. On September 1, 2006 these directors were issued a stock option grant of 30,000 shares based on a strike price of \$4.77 per share for their services for fiscal 2007. Each director was paid for their services from March 1, 2006 to August 31, 2006 with a cash payment of \$7,500 and 1,572 shares of restricted stock, other than the Audit Committee Chair, who received a cash payment of \$10,000 and 1,572 restricted stock.

AGGREGATED OPTION EXERCISES IN FISCAL YEAR 2006 AND YEAR-END OPTION VALUES

| | Shares Acquired on Exercise | Value Realized | Number of Shares Underlying Unexercised Options at August 31, 2005 | | Value In- Exerc |
|--|--------------------------------|-------------------|---|---------------|-----------------------|
| | | | Exercisable | Unexercisable | |
| Paul F. Turner, Chairman of the Board, Sr. VP and Chief Technology Officer | | | 200,000 | 100,000 | \$700, |
| Hyrum A. Mead, President | 14,000 | \$63,140 | 546,415 | 133,333 | \$2,05 |

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EMPLOYMENT CONTRACTS

We entered into an employment agreement with Mr. Mead dated August 10, 1999. This agreement provides that Mr. Mead shall receive an annual base salary of \$125,000, which shall be reviewed annually by the Board of Directors. The agreement provides that if Mr. Mead is involuntarily terminated, Mr. Mead will receive severance compensation for a period of six months, including an extension of all benefits and perquisites. The severance amount shall include six months of salary at the highest rate paid to Mr. Mead prior to termination and an additional amount equal to all bonuses received by Mr. Mead during the

39

12-month period preceding termination (excluding any signing bonus received during such period). The agreement also requires us to vest any options granted to Mr. Mead for the purchase of our common stock, allowing a 90-day period for Mr. Mead to exercise those options. Mr. Mead's agreement includes a non-competition covenant prohibiting him from competing with us for one year following his termination.

We entered into an employment agreement with Mr. Turner dated November 2, 1988. The agreement provides that Mr. Turner's salary will be based upon a reasonable mutual agreement. The agreement provides that if Mr. Turner's employment is involuntarily terminated, he will receive severance pay for a one-year period, which pay includes an extension of all of his rights, privileges and benefits as an employee (including medical insurance). The one-year severance pay shall be equal to Mr. Turner's regular salary for the 12-month period immediately prior to the termination. The agreement also requires us to pay Mr. Turner for any accrued, unused vacation at the time of termination. We are also obligated to pay Mr. Turner \$1,000 (or the equivalent value in stock options) for each newly issued patent obtained by us as a result of Mr. Turner's efforts (Mr. Turner receives only \$500 if multiple inventors are involved). Mr. Turner's agreement includes a non-competition covenant prohibiting him from competing with us for one year following his termination. We may continue the non-competition period for up to four additional years by notifying Mr. Turner in writing and by continuing the severance payments for the additional years during which the non-competition period is extended.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND ----- RELATED STOCKHOLDER MATTERS -----

The following table sets forth, as of October 24, 2006, the beneficial ownership of our outstanding common stock by:

- o each person (including any group) known to us to own more than 5% of any class of our common stock,
- o each of our executive officers,
- o each of our directors, and
- o all executive officers and directors as a group.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission, and generally includes voting or investment power with respect to securities. For purposes of calculating the percentages shown in the table, each person listed is deemed to beneficially own any shares

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issuable on the exercise of vested options and warrants held by that person that are exercisable within 60 days after November 20, 2006, Except as indicated by footnote, the persons named in the table have sole voting and investment power with respect to all shares of common stock shown beneficially owned by them. The inclusion of any shares as beneficially owned does not constitute an admission of beneficial ownership of those shares. The percentage calculation of beneficial ownership is based on 21,040,116 shares of common stock outstanding as of November 20, 2006. Except as otherwise noted, the address of each person listed on the following table is 2188 West 2200 South, Salt Lake City, Utah 84119.

40

| Title of Class | Name of Beneficial Owner | Common Stock Beneficially Owned | |
|-------------------------|--|------------------------------------|---------|
| ----- | ----- | Shares | Percent |
| Officers and Directors | | | |
| Common Stock | Dr. Gerhard W. Sennewald (1) | 6,903,051 | 32.65% |
| Common Stock | Paul F. Turner (2) | 2,085,342 | 9.81% |
| Common Stock | Hyrum A. Mead (3) | 655,402 | 3.03% |
| Common Stock | Dr. Michael Nobel (4) | 244,170 | 1.15% |
| Common Stock | Douglas P. Boyd (5) | 9,353 | * |
| Common Stock | Steven G. Stewart | 2,115 | * |
| Holders of More Than 5% | | | |
| Common Stock | John E. Langdon (6) | 1,295,010 | 6.15% |
| Common Stock | All Executive Officers and Directors as a Group (5 persons) (7) | 9,899,433 | 45.16% |

* Less than 1%

- (1) Includes 100,000 shares subject to options. Does not include 500,000 shares held by Dr. Sennewald's spouse, for which he disclaims beneficial ownership.
- (2) Includes 200,000 shares subject to options.
- (3) Includes 546,415 shares subject to options.
- (4) Includes 25,000 shares subject to options.
- (5) Includes 5,000 shares subject to options.
- (6) Includes 351,862 shares owned directly by Mr. Langdon. The remaining shares are held in trusts for which Mr. Langdon is Trustee. Does not include 50,000 shares held by Mr. Langdon's spouse, for which he disclaims beneficial ownership. Mr. Langdon's address is: 2501 Parkview Drive, Suite 500, Fort Worth, TX 76102.
- (7) Includes 876,415 shares subject to options.

We have two equity compensation plans, our 1998 Employee Stock Option Plan and our 1998 Director Stock Plan, both of which were approved by our stockholders. Shown below on an aggregate basis is a summary of equity compensation plan information with respect to our equity compensation plans:

41

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EQUITY COMPENSATION PLAN INFORMATION

| | Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a) | Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b) | Numb Remai Futu Equity (Exc Reflec |
|---|---|---|---|
| Equity Compensation Plans Approved by Security Holders | 1,809,051 | 1.72 | |
| Equity Compensation Plans not Approved by Security Holders | - | - | |
| Total | 1,809,051 | \$1.72 | |

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Medizin-Technik GmbH. We supply equipment components to Medizin-Technik GmbH located in Munich, Germany, which is a significant distributor of our products in Europe. Medizin-Technik purchases equipment, which it installs, and components to service our hyperthermia therapy systems that it sells to its customers in Europe. We had revenue of \$689,086 in fiscal 2006 from the sale of systems and various component parts sold to Medizin-Technik. During fiscal 2005, we had sales of \$987,472 to Medizin-Technik. Dr. Gerhard W. Sennewald, one of our directors and significant stockholders, is the President and Chief Executive Officer of Medizin-Technik and its sole stockholders. Management believes the terms of the transactions with Medizin-Technik were arms length and fair to the Company.

ITEM 13. EXHIBITS

The following exhibits are incorporated herein by reference as indicated:

| Exhibit Number | Description |
|-------------------|---|
| 3.1 | Amended and Restated Certificate of Incorporation. Incorporated by reference to Exhibit 3.1 of the BSD Medical Corporation Annual Report Form 10-KSB, filed December 1, 2003. |
| 3.2 | By-Laws. Incorporated by reference to Exhibit 3.2 of the BSD Medical Corporation Registration Statement on Form S-1, filed October 16, 1986. |
| 4.1 | Specimen Common Stock Certificate. Incorporated by reference to Exhibit 4 of the BSD Medical Corporation Registration Statement on Form S-1, filed October 16, 1986. |

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42

- 4.2 Emerson Securities Purchase Agreement. Incorporated by reference to Exhibit 4.1 of the BSD Medical Corporation Annual Report on Form 10-KSB, filed December 1, 2003.
- 10.1 Transfer of Trade Secrets Agreement dated December 7, 1979, among BSD Medical Corporation, Vitek, Incorporated and Ronald R. Bowman. Incorporated by reference to Exhibit 10.6 of the BSD Medical Corporation Registration Statement on Form S-1, filed October 16, 1986.
- 10.2 Second Addendum to Exclusive Transfer of Trade Secrets Agreement dated April 2, 1987. Incorporated by reference to Exhibit 10 of the BSD Medical Corporation Annual Report on Form 10-K, filed April 8, 1988.
- 10.3 License Agreement between BSD Medical Corporation and EDAP Technomed, Inc., dated July 3, 1996. Incorporated by reference to Exhibit 10 of Current Report on Form 8-K, filed August 7, 1996.
- 10.4 Stock Purchase Agreement dated October 31, 1997, by and among TherMatrix, Inc., BSD Medical Corporation, Oracle Strategic Partners, L.P. and Charles Manker. Incorporated by reference to Exhibit 10.6 of the BSD Medical Corporation Annual Report on Form 10-KSB filed December 10, 1998.
- 10.5 BSD Medical Corporation 1998 Director Stock Plan. Incorporated by reference to Exhibit A of the BSD Medical Corporation Schedule 14A, filed July 27, 1998.
- 10.6 BSD Medical Corporation 1998 Stock Incentive Plan. Incorporated by reference to Exhibit B of the BSD Medical Corporation Schedule 14B, filed July 27, 1998.
- 21 Subsidiary List. Incorporated by reference to Exhibit 21 of the BSD Medical Corporation Annual Report on Form 10-KSB filed December 1, 2003.
- 31.1 Certification of Chief Executive Officer of BSD pursuant to Rule 13a-14.
- 31.2 Certification of Chief Financial Officer of BSD pursuant to Rule 13a-14.
- 32.1 Certification of Chief Executive Officer attached pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer of BSD pursuant to 18 U.S.C. ss.1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The following table presents fees for professional services rendered by Tanner LC for the audit of our annual financial statements for the fiscal years

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ended August 31, 2006 and August 31, 2005 and fees billed for other services rendered by Tanner LC during those periods.

43

| | Fiscal 2006 | Fiscal 2005 |
|-----------------------|-------------|-------------|
| Audit Fees(1) | \$75,500 | \$52,619 |
| Audit-Related Fees(2) | 6,265 | 5,902 |
| Tax Fees(3) | - | 23,075 |
| All Other Fees(4) | - | 1,560 |
| Total | \$81,765 | \$83,156 |

- (1) Audit Fees consist of fees billed for the annual audits and quarterly reviews.
- (2) Audit-Related Fees consist of fees billed for various SEC filings and accounting research.
- (3) Tax Fees consist of fees billed for tax consultation and assistance in the preparation of tax returns.
- (4) All Other Fees consist of fees for edgarization of SEC filings and miscellaneous fees.

Pre-Approval Policies

The Audit Committee pre-approved all audit, audit-related and non-audit services performed by our independent auditors and subsequently reviewed the actual fees and expenses paid to Tanner LC. The Audit Committee has determined that the fees paid to Tanner LC for non-audit services are compatible with maintaining Tanner LC's independence as our auditors.

44

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BSD MEDICAL CORPORATION

Date: November 29, 2006

By: /s/ Hyrum A. Mead

Hyrum A. Mead
President and Member of the Board of
Directors (principal executive officer)

Date: November 29, 2006

By: /s/ Dennis Bradley

Dennis Bradley
Controller (principal financial and
accounting officer)

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

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Date: November 29, 2006

By: /s/ Paul F. Turner

Paul F. Turner
Chairman of the Board, Senior Vice
President and Chief Technology Officer

Date: November 29, 2006

By: /s/ Hyrum A. Mead

Hyrum A. Mead
President and Member of the Board of
Directors (principal executive officer)

Date: November 29, 2006

By: /s/ Gerhard W. Sennewald

Dr. Gerhard W. Sennewald
Member of the Board of Directors

45

Date: November 29, 2006

By: /s/ Steven G. Stewart

Steven G. Stewart
Member of the Board of Directors

Date: November 29, 2006

By: /s/ Michael Nobel

Dr. Michael Nobel
Member of the Board of Directors

Date: November 29, 2006

By: /s/ Douglas P. Boyd

Dr. Douglas P. Boyd
Member of the Board of Directors

46