

BSD MEDICAL CORP  
Form 10-Q  
January 09, 2009

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

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FORM 10-Q

(Mark One)

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

For the quarterly period ended November 30, 2008

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 001-32526

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

Delaware  
(State or other jurisdiction of  
incorporation or organization)

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

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

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

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

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

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Large accelerated filer   
Non-accelerated filer

Accelerated filer   
Smaller reporting company

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

As of January 9, 2009, there were 21,843,673 shares of the Registrant's common stock, \$0.001 par value per share, outstanding.

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BSD MEDICAL CORPORATION  
FORM 10-Q

FOR THE QUARTER ENDED NOVEMBER 30, 2008

PART I - Financial Information

Item 1.	<u>Financial Statements</u>	
	<u>Condensed Balance Sheets</u>	<u>3</u>
	<u>Condensed Statements of Operations</u>	<u>4</u>
	<u>Condensed Statements of Cash Flows</u>	<u>5</u>
	<u>Notes to Condensed Financial Statements</u>	<u>6</u>
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>12</u>
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>20</u>
Item 4.	<u>Controls and Procedures</u>	<u>21</u>

PART II - Other Information

Item 1A.	<u>Risk Factors</u>	<u>21</u>
Item 6.	<u>Exhibits</u>	<u>21</u>
	<u>Signatures</u>	<u>22</u>

## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements.

BSD MEDICAL CORPORATION		
Condensed Balance Sheets		
(Unaudited)		
ASSETS	November 30, 2008	August 31, 2008
Current assets:		
Cash and cash equivalents	\$ 243,209	\$ 1,394,652
Investments	10,312,265	14,487,192
Accounts receivable, net of allowance for doubtful accounts of \$20,000	737,166	439,739
Related party trade accounts receivable	399,344	737,483
Income tax receivable	1,001,438	1,409,996
Inventories, net	1,661,394	1,425,153
Other current assets	89,323	113,829
Total current assets	14,444,139	20,008,044
Property and equipment, net	1,428,117	1,441,524
Patents, net	35,646	37,330
	\$ 15,907,902	\$ 21,486,898
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 530,673	\$ 221,605
Accrued liabilities	499,344	585,777
Customer deposits	307,948	427,677
Deferred revenue – current portion	38,578	41,885
Total current liabilities	1,376,543	1,276,944
Deferred revenue – net of current portion	49,094	54,094
Total liabilities	1,425,637	1,331,038
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.001 par value; 10,000,000 shares authorized, no shares issued and outstanding	-	-

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Common stock; \$.001 par value, 40,000,000 shares authorized, 21,843,673 and 21,388,958 shares issued	21,844	21,389
Additional paid-in capital	27,716,033	27,565,373
Treasury stock, 24,331 shares at cost	(234)	(234)
Other comprehensive loss	(6,532,981)	(2,141,416)
Accumulated deficit	(6,722,397)	(5,289,252)
Total stockholders' equity	14,482,265	20,155,860
	\$ 15,907,902	\$ 21,486,898

See accompanying notes to condensed financial statements

[Return to Table of Contents](#)

BSD MEDICAL CORPORATION  
Condensed Statements of Operations  
(Unaudited)

	Three Months Ended November 30,	
	2008	2007
Revenues:		
Sales	\$ 1,208,396	\$ 479,703
Sales to related parties	23,168	908,025
<b>Total revenues</b>	<b>1,231,564</b>	<b>1,387,728</b>
Operating costs and expenses:		
Cost of sales	600,480	162,981
Cost of related party sales	22,172	277,874
Research and development	507,223	337,353
Selling, general and administrative	1,510,307	1,393,947
<b>Total operating costs and expenses</b>	<b>2,640,182</b>	<b>2,172,155</b>
<b>Loss from operations</b>	<b>(1,408,618)</b>	<b>(784,427)</b>
Other income (expense):		
Interest and investment income	258,732	189,348
Other expense	(34,259)	(63,856)
<b>Total other income (expense)</b>	<b>224,473</b>	<b>125,492</b>
<b>Loss before income taxes</b>	<b>(1,184,145)</b>	<b>(658,935)</b>
(Provision) benefit for income taxes	(249,000)	43,000
<b>Net loss</b>	<b>(1,433,145)</b>	<b>(615,935)</b>
Other comprehensive loss – unrealized loss on investments, net of income tax		
	(4,391,565)	(368,600)
<b>Net comprehensive loss</b>	<b>\$ (5,824,710)</b>	<b>\$ (984,535)</b>
Loss per common share:		
Basic	\$ (0.07)	\$ (0.03)
Diluted	\$ (0.07)	\$ (0.03)
Weighted average number of shares outstanding:		
Basic	21,769,000	21,311,000
Diluted	21,769,000	21,311,000

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See accompanying notes to condensed financial statements

[Return to Table of Contents](#)

BSD MEDICAL CORPORATION  
Condensed Statements of Cash Flows  
(Unaudited)

	Three Months Ended November 30,	
	2008	2007
Cash flows from operating activities:		
Net loss	\$ (1,433,145)	\$ (615,935)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	33,276	26,373
Stock-based compensation	273,173	158,630
Stock issued for services	37,500	30,000
Decrease (increase) in:		
Receivables	40,712	(835,910)
Income tax receivable	249,000	(211,000)
Inventories	(236,241)	(92,436)
Deferred tax assets	-	168,000
Other current assets	24,506	7,227
Increase (decrease) in:		
Accounts payable	309,068	33,629
Accrued liabilities	(86,433)	(72,358)
Customer deposits	(119,729)	(131,573)
Deferred revenue	(8,307)	(7,722)
<b>Net cash used in operating activities</b>	<b>(916,620)</b>	<b>(1,543,075)</b>
Cash flows from investing activities:		
(Purchase) sale of investments	(216,638)	3,072,907
Purchase of property and equipment	(18,185)	(1,205,892)
Increase in patents	-	(20,967)
<b>Net cash (used in) provided by investing activities</b>	<b>(234,823)</b>	<b>1,846,048</b>
Cash flows from financing activities:		
Proceeds from the sale of common stock	-	12,000
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(1,151,443)</b>	<b>314,973</b>
Cash and cash equivalents, beginning of period	1,394,652	416,540
<b>Cash and cash equivalents, end of period</b>	<b>\$ 243,209</b>	<b>\$ 731,513</b>

See accompanying notes to condensed financial statements



[Return to Table of Contents](#)

BSD MEDICAL CORPORATION  
Notes to Condensed Financial Statements  
(Unaudited)

Note 1. Basis of Presentation

The accompanying unaudited condensed balance sheets of BSD Medical Corporation (the “Company”) as of November 30, 2008 and August 31, 2008, the related unaudited condensed statements of operations for the three months ended November 30, 2008 and 2007, and the related unaudited condensed statements of cash flows for the three months ended November 30, 2008 and 2007 have been prepared in accordance with U.S. generally accepted accounting principles for interim financial reporting and pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). The condensed financial statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. These condensed financial statements should be read in conjunction with the notes thereto, and the financial statements and notes thereto included in our annual report on Form 10-K for the year ended August 31, 2008.

All adjustments (consisting only of normal recurring adjustments) necessary for the fair presentation of our financial position as of November 30, 2008 and August 31, 2008, our results of operations for the three months ended November 30, 2008 and 2007, and our cash flows for the three months ended November 30, 2008 and 2007 have been included. The results of operations for the three months ended November 30, 2008 may not be indicative of the results for the year ending August 31, 2009.

Note 2. Net Income (Loss) Per Common Share

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

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

	Three Months Ended November 30,	
	2008	2007
Weighted average number of shares outstanding – basic	21,769,000	21,311,000
Dilutive effect of stock options	-	-
Weighted average number of shares outstanding – diluted	21,769,000	21,311,000

No stock options are included in the computation of diluted weighted average number of shares for the three months ended November 30, 2008 and 2007 because the effect would be anti-dilutive. At November 30, 2008, the Company had outstanding options to purchase a total of 1,851,600 common shares of the Company that could have a future dilutive effect on the calculation of earnings per share.

[Return to Table of Contents](#)

## Note 3. Inventories

Inventories consist of the following:

	November 30, 2008	August 31, 2008
Parts and supplies	\$ 999,047	\$ 802,956
Work-in-process	648,541	608,391
Finished goods	53,806	53,806
Reserve for obsolete inventory	(40,000)	(40,000)
<b>Inventories, net</b>	<b>\$ 1,661,394</b>	<b>\$ 1,425,153</b>

## Note 4. Property and Equipment

Property and equipment consist of the following:

	November 30, 2008	August 31, 2008
Equipment	\$ 1,059,447	\$ 1,048,061
Furniture and fixtures	298,576	298,576
Leasehold improvements	24,220	17,420
Building	956,000	956,000
Land	244,000	244,000
	2,582,243	2,564,057
Less accumulated depreciation	(1,154,126)	(1,122,533)
<b>Property and equipment, net</b>	<b>\$ 1,428,117</b>	<b>\$ 1,441,524</b>

## Note 5. Related Party Transactions

During the three months ended November 30, 2008 and 2007, we had sales of \$23,168 and \$908,025, respectively, to an entity controlled by a significant stockholder and member of the Board of Directors. These related party transactions represent approximately 2% and 65% of total sales for each respective three-month period.

At November 30, 2008 and August 31, 2008, receivables included \$399,344 and \$737,483, respectively, from this entity.

## Note 6. Stock-Based Compensation

We have both an employee and director stock option plan, which are described more fully in Note 10 in our 2008 Annual Report on Form 10-K. As of November 30, 2008, we had approximately 1,262,000 shares of common stock reserved for future issuance under the stock option plans.

[Return to Table of Contents](#)

7

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The Company accounts for stock-based compensation in accordance with SFAS No. 123(R), Share Based Payments. Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the value of the award granted using the Black-Scholes option pricing model, and recognized over the period in which the award vests. The stock-based compensation expense for the three-month periods ended November 30, 2008 and 2007 has been allocated to the various categories of operating costs and expenses in a manner similar to the allocation of payroll expense as follows:

	Three Months Ended November 30,	
	2008	2007
Cost of sales	\$ 18,429	\$ 21,148
Research and development	42,329	25,495
Selling, general and administrative	212,415	111,987
<b>Total</b>	<b>\$ 273,173</b>	<b>\$ 158,630</b>

During the three months ended November 30, 2008, we granted 235,000 options to our directors and employees, 150,000 options with one fifth vesting each year for the next five years, and 85,000 options with one third vesting each year for the next three years. These grants account for \$55,984 of the total stock-based compensation expense for the three months ended November 30, 2008.

Unrecognized stock-based compensation expense expected to be recognized over the estimated weighted-average amortization period of 3.64 years is approximately \$3,088,000 at November 30, 2008.

Our weighted-average assumptions used in the Black-Scholes valuation model for equity awards with time-based vesting provisions granted during the three months ended November 30, 2008 are shown below:

Expected volatility	62.11%
Expected dividends	0%
Expected term	6.0 Years
Risk-free interest rate	3.35%

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

The weighted-average grant-date fair value of stock options granted during the three months ended November 30, 2008 was \$4.37.

A summary of the time-based stock option awards as of November 30, 2008, and changes during the three months then ended, is as follows:

[Return to Table of Contents](#)

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	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contract Term (Years)	Aggregate Intrinsic Value
Outstanding at August 31, 2008	2,182,629	\$ 3.02		
Granted	235,000	7.32		
Exercised	(516,029)	0.94		
Forfeited or expired	(50,000)	7.04		
Outstanding at November 30, 2008	1,851,600	\$ 4.09	7.56	
Exercisable at November 30, 2008	1,007,410	\$ 2.67	6.43	\$1,502,264

Note 7. Income Taxes

The income tax (provision) benefit consists of the following:

	Three Months Ended November 30,	
	2008	2007
Current	\$ (20,000)	\$ 211,000
Deferred	(229,000)	(168,000)
Total	\$ (249,000)	\$ 43,000

The current provision for income tax of \$20,000 in the three months ended November 30, 2008 resulted from a decrease in our income tax receivable due to a change in the amount of taxable loss and tax credits that we can carry back to offset income taxes previously paid. The current income tax benefit of \$211,000 in the three months ended November 30, 2007 represents an increase in our income tax receivable resulting from our ability to carry back our taxable loss in that period to offset income taxes previously paid.

The deferred income tax provision of \$229,000 and \$168,000 in the three months ended November 30, 2008 and 2007, respectively, resulted from our recording a valuation allowance against our deferred tax assets. In recording the valuation allowance, we were unable to conclude that it is more likely than not that our deferred tax assets, including our taxable loss and tax credit carry forwards, will be realized. In reaching this determination, we evaluated factors such as prior earnings history, expected future earnings and our ability to carry back reversing items within two years to offset income taxes paid.

Note 8. Supplemental Cash Flow Information

The Company paid no amounts for interest during the three months ended November 30, 2008 and 2007. The Company paid no amounts for income taxes during the three months ended November 30, 2008 and 2007.

[Return to Table of Contents](#)



During the three months ended November 30, 2008, the Company had the following non-cash financing and investing activities:

- Increased other comprehensive loss and decreased investments by \$4,391,565.
- Increased common stock and decreased additional paid-in capital by \$450.
- Decreased income tax receivable and additional paid-in capital by \$159,558.

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

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

#### Note 9. Recent Accounting Pronouncements

On May 9, 2008, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 162, The Hierarchy of Generally Accepted Accounting Principles. This statement is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements in conformity with U.S. generally accepted accounting principles (GAAP) for nongovernmental entities. The statement establishes that the GAAP hierarchy should be directed to entities because it is the entity (not its auditor) that is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. This statement is effective 60 days following the SEC’s approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. We do not believe the implementation of this statement will have a material impact on our financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities. This statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, or our fiscal year beginning September 1, 2009, with early application encouraged. This statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. We currently are unable to determine what impact the future application of this pronouncement may have on our financial statements.

[Return to Table of Contents](#)



In December 2007, the FASB issued SFAS No. 141(R) (revised 2007), Business Combinations. This statement replaces SFAS No. 141, Business Combinations and applies to all transactions or other events in which an entity (the acquirer) obtains control of one or more businesses (the acquiree), including those sometimes referred to as “true mergers” or “mergers of equals” and combinations achieved without the transfer of consideration. This statement establishes principles and requirements for how the acquirer: a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This statement will be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, or our fiscal year beginning September 1, 2009. Earlier adoption is prohibited. We currently are unable to determine what impact the future application of this pronouncement may have on our financial statements.

In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements. This statement applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, and amends Accounting Research Bulletin (“ARB”) 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It also amends certain of ARB 51’s consolidation procedures for consistency with the requirements of SFAS No. 141(R) (revised 2007). This statement will be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, or our fiscal year beginning September 1, 2009. Earlier adoption is prohibited. We currently are unable to determine what impact the future application of this pronouncement may have on our financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS No. 159 apply only to entities that elect the fair value option. However, the amendment to SFAS No. 115 Accounting for Certain Investments in Debt and Equity Securities applies to all entities with available-for-sale and trading securities. SFAS No. 159 is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007. We adopted SFAS No. 159 on September 1, 2008, with no material impact on our financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy as defined in the standard. Additionally, companies are required to provide enhanced disclosure regarding financial instruments in one of the categories, including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. In February 2008, the FASB issued FASB Staff Position (FSP) No. FAS 157-2, which delays by one year the effective date of SFAS No. 157 for certain types of non-financial assets and non-financial liabilities. As a result, SFAS No. 157 will be effective for financial statements issued for fiscal years beginning after November 15, 2007 for financial assets and liabilities carried at fair value on a recurring basis, and for fiscal years beginning after November 15, 2008 for non-recurring non-financial assets and liabilities that are recognized or disclosed at fair value. In October 2008, the FASB issued FSP No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active, or FSP 157-3. FSP 157-3 clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP 157-3 was effective upon issuance, including prior periods for which financial statements have not been issued.

We adopted SFAS No. 157 for financial assets and liabilities carried at fair value on a recurring basis on September 1, 2008, with no material impact on our financial statements. We are currently unable to determine the impact on our financial statements of the application of SFAS No. 157 on September 1, 2009, for non-recurring non-financial assets

and liabilities that are recognized or disclosed at fair value.

[Return to Table of Contents](#)

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

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

General

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

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 addressing the needs of men's health. 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, nearly 40% of cancer patients continue to die from the disease in the United States. Commercialization of our systems used to treat cancer 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 through a number of biological mechanisms. Our MicroThermX-100 Microwave Ablation System is used to ablate soft tissue 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. Our cancer treatment systems have been used to treat thousands of patients throughout the world, and have received much notoriety, including the Frost & Sullivan "Technology Innovation of the Year Award" for cancer therapy devices awarded for the development of the BSD-2000.

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.