UROPLASTY INC
Form 10QSB
August 14, 2006

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

Quarterly Report Under section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended June 30, 2006
Commission File No. 000-20989
UROPLASTY, INC.

(Name of Small Business Issuer in its Charter)

Minnesota, U.S.A.	**41-1719250**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

5420 Feltl Road
Minnetonka, Minnesota, 55343

(Address of principal executive offices)

(912) 426-6140

(Issuer s telephone number, including area code)

Securities registered under Section 12(g) of the Exchange Act: Common Stock, $.01 par value (Title of class)

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 Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES þ NO o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act:

YES o NO þ

The number of shares outstanding of the issuer s only class of common stock on July 31, 2006 was 6,965,206.

Transitional Small Business Disclosure Format:

YES o NO þ

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

UROPLASTY, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	June 30, 2006 (unaudited)	March 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 1,394,306	$ 1,563,433
Short-term investments		1,137,647
Accounts receivable, net	936,816	716,587
Income tax receivable	170,290	270,934
Inventories	731,663	757,062
Other	415,107	353,178
Total current assets	3,648,182	4,798,841
Property, plant, and equipment, net	1,445,778	1,079,438
Intangible assets, net	385,067	411,604
Deferred tax assets	139,505	111,361
Total assets	$ 5,618,532	$ 6,401,244

See accompanying notes to the condensed interim consolidated financial statements.

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UROPLASTY, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	June 30, 2006 (unaudited)	March 31, 2006
Liabilities and Shareholders Equity		
Current liabilities:		
Current maturities long-term debt	$ 43,998	$ 41,658
Current maturities deferred rent	35,000	
Notes payable	185,426	
Accounts payable	552,704	506,793
Accrued liabilities	632,197	917,981
Warrant liability	337,624	665,356
Total current liabilities	1,786,949	2,131,788
Long-term debt less current maturities	400,101	389,241
Deferred rent less current maturities	239,433	
Accrued pension liability	573,267	473,165
Total liabilities	2,999,750	2,994,194
Shareholders equity:		
Common stock $.01 par value; 20,000,000 shares authorized, 6,965,206 and 6,937,786 shares issued and outstanding at June 30 and March 31, 2006, respectively	69,652	69,378
Additional paid-in capital	15,199,298	14,831,787
Accumulated deficit	(12,275,339)	(11,034,100)
Accumulated other comprehensive loss	(374,829)	(460,015)
Total shareholders equity	2,618,782	3,407,050
Total liabilities and shareholders equity	$ 5,618,532	$ 6,401,244

See accompanying notes to the condensed interim consolidated financial statements.

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UROPLASTY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005
Net sales	$ 1,764,210	$ 1,645,653
Cost of goods sold	555,516	420,828
Gross profit	1,208,694	1,224,825
Operating expenses		
General and administrative	884,109	690,564
Research and development	674,954	630,598
Selling and marketing	1,232,587	664,033
	2,791,650	1,985,195
Operating loss	(1,582,956)	(760,370)
Other income (expense)		
Interest income	19,507	27,380
Interest expense	(5,982)	(4,809)
Warrant benefit (expense)	327,732	(686,295)
Foreign currency exchange gain (loss)	26,411	(1,199)
Other	4,800	
	372,468	(664,923)
Loss before income taxes	(1,210,488)	(1,425,293)
Income tax expense	30,751	37,020
Net loss	$ (1,241,239)	$ (1,462,313)
Basic and diluted loss per common share	$ (0.18)	$ (0.23)
Weighted average common shares outstanding:		
Basic and diluted	6,952,167	6,351,245

See accompanying notes to the condensed interim consolidated financial statements.

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UROPLASTY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY AND COMPREHENSIVE LOSS
Three months ended June 30, 2006
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders Equity
Balance at March 31, 2006	6,937,786	$ 69,378	$ 14,831,787	$ (11,034,100)	$(460,015)	$ 3,407,050
Exercise of Stock Options	9,666	96	12,702			12,798
Employee Retirement Savings Plan Contribution	17,754	178	44,207			44,385
Share-Based Compensation			310,602			310,602
Comprehensive Loss:						
Net loss				(1,241,239)		
Translation adjustment					96,589	
Additional pension liability					(11,403)	
Total comprehensive loss						(1,156,053)
Balance at June 30, 2006	6,965,206	$ 69,652	$ 15,199,298	$ (12,275,339)	($ 374,829)	$ 2,618,782

See accompanying notes to the condensed interim consolidated financial statements.

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UROPLASTY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Three Months Ended June 30, 2006 and 2005
(Unaudited)

	Three Months Ended June 30,	
	2006	**2005**
Cash flows from operating activities:		
Net loss	$ (1,241,239)	$ (1,462,313)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	78,295	54,319
Gain on disposal of assets	(4,800)	
Warrant expense (benefit)	(327,732)	686,295
Stock-based consulting expense	11,007	
Stock-based compensation expense	299,595	
Deferred income taxes	(21,495)	7,453
Deferred rent	(5,833)	
Changes in operating assets and liabilities:		
Accounts receivable	(178,338)	(37,436)
Inventories	76,937	(222,364)
Other current assets and income tax receivable	59,400	(92,228)
Accounts payable	35,354	11,650
Deferred rent	274,433	
Accrued liabilities	(207,912)	165,265
Accrued pension liability	27,025	19,613
Net cash used in operating activities	(1,125,303)	(869,746)
Cash flows from investing activities:		
Purchase of short-term investments		(2,103,402)
Proceeds from sale of short-term investments	1,137,647	87,359
Payments for property, plant and equipment	(371,825)	(129,474)
Proceeds from sale of property, plant and equipment	4,800	
Payments for intangible assets		(266,667)
Net cash provided by (used in) investing activities	770,622	(2,412,184)
Cash flows from financing activities:		
Proceeds from financing obligations	210,999	
Repayment of long-term obligations	(36,374)	(10,819)
Proceeds from issuance of common stock and warrants	12,798	6,824,069
Net cash provided by financing activities	187,423	6,813,250
Effect of exchange rates on cash and cash equivalents	(1,869)	(81,808)

Net increase (decrease) in cash and cash equivalents	(169,127)	3,449,512
Cash and cash equivalents at beginning of period	1,563,433	1,405,324
Cash and cash equivalents at end of period	$ 1,394,306	$ 4,854,836
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$ 7,081	$ 5,056
Cash paid during the period for income taxes	23,121	15,281
Supplemental disclosure of non-cash financing and investing activities:		
Shares issued for 401(k) plan profit sharing contribution	$ 44,408	$
Property, plant and equipment additions funded by lessor allowance and classified as deferred rent	280,000	

See accompanying notes to the condensed interim consolidated financial statements.

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

1. Basis of Presentation

We have prepared our condensed interim consolidated financial statements included in this Form 10-QSB, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted, pursuant to such rules and regulations. The consolidated results of operations for any interim period are not necessarily indicative of results for a full year. These condensed interim consolidated statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-KSB for the year ended March 31, 2006.

The condensed interim consolidated financial statements presented herein as of June 30, 2006 and for the three-month periods ended June 30, 2006 and 2005 reflect, in the opinion of management, all material adjustments consisting only of normal recurring adjustments necessary for a fair presentation of the consolidated financial position, results of operations and cash flows for the interim periods.

We have identified certain accounting policies that we consider particularly important for the portrayal of our results of operations and financial position and which may require the application of a higher level of judgment by our management, and as a result are subject to an inherent level of uncertainty. These are characterized as critical accounting policies and address revenue recognition, accounts receivable, inventories, foreign currency translation and transactions, impairment of long-lived assets, share-based compensation and income taxes, each of which is more fully described in our Annual Report on Form 10-KSB for the year ended March 31, 2006. Based upon our review, we have determined that these policies remain our most critical accounting policies for the three-month period ended June 30, 2006, and we have made no changes to these policies during fiscal 2007.

2. Nature of Business, Sales of Common Stock and Corporate Liquidity

The majority of our products are sold primarily outside of the United States. The 510(k) premarket clearance from the U.S. Food and Drug Administration (FDA) was received in August 2005 for our I-STOP™ Mid-Urethral Sling, a biocompatible, tension-free sling used to treat female urinary incontinence. In October 2005 and July 2006, we received the 510(K) premarket clearances for, respectively, the original and enhanced versions of our Urgent® PC Neurostimulation System, a proprietary, minimally invasive nerve stimulation device designed for office-based treatment of overactive bladder symptoms of urge incontinence, urinary urgency and urinary frequency. We have established a sales force in the United States to commercialize these products and anticipate increasing our sales and marketing organization. We continue to pursue regulatory approvals to market other products in the United States. The FDA approval process can be costly, lengthy and uncertain.

Our future liquidity and capital requirements will depend on numerous factors, including among other things, the timing and cost of obtaining FDA approval for the Macroplastique premarket approval application (PMA) and expanding the sales, marketing and distribution capabilities in the U.S. market. We will need to raise additional debt or equity financing to continue funding for product development and continued expansion of our sales and marketing activities for beyond fiscal 2007, and ultimately, we will need to achieve profitability and generate positive cash flows from operations. Aside from the recently established credit lines indicated below and proceeds from a private placement (see Note 15), we have no committed resources of, or other arrangements with respect to, additional financing.

In May 2006 we entered into a business loan agreement with Venture Bank. The agreement provides for a credit line of up to $1 million secured by substantially all of our assets. We may borrow up to 50% of the value of the inventory on hand in the U.S. and 75% of the U.S. accounts receivable value; provided however, we cannot borrow any amount if our consolidated shareholders equity declines below $0.5 million. We may borrow the maximum $1 million only if our consolidated shareholders equity is not less than $1 million. For consolidated shareholders equity in excess of $0.5 million but less than $1 million, the maximum that we can borrow is $250,000. The bank charges us interest on the loan at the rate of 1 percentage point over the prime rate (8.25% at June 30, 2006) subject to a minimum interest rate of 7% per annum.

In June 2006, we entered into a $100,000 3-year, term loan agreement with Venture Bank, at an interest rate of 8.25% per annum. In addition, Uroplasty BV, one of our subsidiaries entered into an arrangement with Rabobank of The Netherlands for a 200,000 (approximately $258,500) credit line.

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At June 30, 2006, we had no borrowings against any of our credit lines.

3. Short-term Investments

At March 31, 2006, short-term investments consisted of certificates of deposit that matured in the first quarter of fiscal 2007.

4. Inventories

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

	June 30, 2006	March 31, 2006
Raw materials	$ 345,110	$ 379,685
Work-in-process	67,950	26,183
Finished goods	418,408	453,633
Reserve	(99,805)	(102,439)
	$ 731,663	$ 757,062

5. Intangible Assets

Intangible assets are comprised of patents, trademarks and licensed technology which are amortized on a straight-line basis over their estimated useful lives or contractual terms, whichever is less.

		June 30, 2006		
	Estimated Lives (Years)	Gross Carrying Amount	Accumulated Amortization	Net value
Licensed technology	5	$ 501,290	$ 136,028	$ 365,262
Patents and inventions	6	237,900	218,095	19,805
Totals		$ 739,190	$ 354,123	$ 385,067

			March 31, 2006	
Licensed technology	5	$ 501,290	$ 111,183	$ 390,107
Patents and inventions	6	237,900	216,403	21,497
Totals		$ 739,190	$ 327,586	$ 411,604

Estimated annual amortization for these assets for the fiscal years ended March 31 is as follows:

Remainder of fiscal 2007	$ 77,000
2008	100,800
2009	100,700
2010	98,400
2011	8,200
	$ 385,100

6. Comprehensive Loss

Comprehensive loss consists of net loss, translation adjustments and additional pension liability as follows:

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	Three Months Ended June 30, 2006	2005
Net loss	$ (1,241,239)	$ (1,462,313)
Items of other comprehensive income (loss):		
Translation adjustment	96,589	(208,159)
Additional pension liability	(11,403)	4,409
Comprehensive loss	$ (1,156,053)	$ (1,666,063)

7. Options and Warrants

The following options and warrants outstanding at June 30, 2006 and 2005 to purchase shares of common stock were excluded from diluted loss per common share because of their anti-dilutive effect:

	Number of Options/Warrants	Range of Exercise Prices
For the three months ended:		
June 30, 2006	4,038,460	$0.90 to $10.50
June 30, 2005	3,706,338	$0.90 to $10.50

8. Shareholders Equity

Warrants

As a result of the suspension of the exercise of the 706,218 warrants we originally issued in July 2002, we granted a like number of new common stock purchase warrants to the holders of the expired warrants in April 2005. The new warrants are exercisable at $2.00 per share for 90 days after the effective date of a registration statement covering the shares underlying these warrants. As of June 30, 2006, such a registration statement had been filed, however, the Securities and Exchange Commission had not declared it effective. In April 2005, we recognized a liability and a charge to equity of approximately $1.4 million associated with the grant of these new warrants. We determined the fair value of these warrants using the Black-Scholes option-pricing model. We have since reduced the reported liability by approximately $1,062,000 due to the decrease in the fair value of these warrants from their date of issuance through June 30, 2006. We recorded a warrant benefit of $328,000 in the three-months ended June 30, 2006 and a warrant expense of $686,000 in the three-months ended June 30, 2005. We will continue to remeasure the value of this liability in relation to its fair value and adjust accordingly until such time as the warrants are exercised or expire.

In connection with our April 2005 private placement, we issued 1,180,928 warrants to purchase shares of common stock and registered the public resale the underlying shares for the security holders. The warrants are exercisable for five years at an exercise price of $4.75.

As part of a consulting agreement with CCRI Corporation, we issued a warrant to purchase 50,000 shares of common stock at a price of $3.00 per share on April 1, 2003, and an additional warrant to purchase 50,000 shares at a price of $5.00 on November 2, 2003. At June 30, 2006, all of these warrants were outstanding and expire five years from the date of issue.

9. Share-based Compensation

As of June 30, 2006, we had one active plan (2006 Stock and Incentive Plan) for share-based compensation awards. Under the plan, if we have a change in control, all outstanding awards, including those subject to vesting or other performance targets, fully vest immediately. We have reserved 1,200,000 shares of our common stock for stock-based awards under this plan, and as of June 30, 2006, we had granted awards for 38,000 options. We generally grant option awards with an exercise price equal to the market price of our stock at the date of the grant.

On April 1, 2006, we adopted Statement of Financial Accounting Standards No. 123(R), Share-Based Payment Revised 2004 (SFAS No. 123(R)), using the modified prospective transition method. Prior to the adoption of SFAS No. 123(R), we accounted for stock option grants in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees (the intrinsic value method), and accordingly, recognized no compensation expense for stock option grants.

Under the modified prospective method, we recognize share-based employee compensation cost using the fair-value based method for all new awards granted after April 1, 2006 and to awards outstanding on April 1, 2006 that we subsequently modify, repurchase or cancel. We recognize compensation costs for unvested stock options and awards that are outstanding as of the April 1, 2006 adoption date, over the remaining requisite service period based on the grant-date fair value of those options and awards as previously calculated under the pro-forma disclosures pursuant to Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS No. 123). We were not required to restate prior periods to reflect the impact of adopting the new standard. We incurred a total of $310,602 in compensation expense in the first quarter of fiscal 2007 as a result of our adoption of SFAS No. 123(R).

As a result of adopting SFAS No. 123(R), for the three months ended June 30, 2006, our loss before taxes, net loss, and basic and diluted loss per share were higher than if we had continued to account for stock-based compensation under APB Opinion No. 25 for our stock option grants (see chart below).

	As Reported	Proforma Under APB 25
Loss before taxes	$ (1,210,488)	$ (1,210,488)
Add back compensation expense		310,602
Adjusted loss before taxes	(1,210,488)	(899,886)
Income tax expense	30,751	30,751
Net loss	$ (1,241,239)	$ (930,637)
Net loss per common share basic and diluted	$ (0.18)	$ (0.13)

Proceeds from the exercise of stock options were $12,798 for the three months ended June 30, 2006.

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The following table illustrates the effect on operating results and per share information had the Company accounted for stock-based compensation in accordance with SFAS No. 123(R) for the three months ended June 30, 2005, and reported compensation expense of $433,431. We intend to show similar pro forma information in our future fiscal 2007 reports because we believe this presentation facilitates a quarter-to-quarter understanding of the effect of SFAS No. 123(R) on our fiscal 2007 results.

	Three Months Ended June 30,	
	2006	**2005**
Net loss As reported	$ (1,241,239)	$ (1,426,313)
Deduct: Total stock-based employee compensation expense determined under fair value-based method		(433,431)
Net loss Pro forma	$ (1,241,239)	$ (1,895,744)
Net loss per common share As reported:		
Basic and diluted	$ (0.18)	$ (0.23)
Net loss per common share Pro forma:		
Basic and diluted	$ (0.18)	$ (0.30)

We determined the fair value of our option awards using the Black-Scholes option pricing model. We used the following weighted-average assumptions to value the options granted during the first quarter of fiscal 2007:

Expected life in years	8.97
Risk-free interest rate	5.06%
Expected volatility	