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BIOANALYTICAL SYSTEMS INC
Form 10-Q/A
November 01, 2006

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

FORM 10-Q/A

(Mark One)

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

For the quarterly period ended June 30, 2006

OR

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 0-23357

BIOANALYTICAL SYSTEMS, INC.
(Exact name of the registrant as specified in its charter)

INDIANA
(State or other jurisdiction of incorporation or organization)

35-1345024
(I.R.S. Employer Identification No.)

2701 KENT AVENUE
WEST LAFAYETTE, IN
(Address of principal executive offices)

47906
(Zip code)

(765) 463-4527
(Registrant's telephone number, including area code)

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

YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-accelerated Filer

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

YES NO

As of July 31, 2006, 4,892,127 common shares of the registrant were outstanding.

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PART I FINANCIAL INFORMATION

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PART I Financial Information
Item 1. Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)
(Unaudited)

	June 30, 2006	Sept. 30, 2005
	(Restated)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 777	\$ 1,254
Accounts receivable		
Trade	7,690	10,352
Unbilled revenues and other	1,752	2,677
Inventories	1,889	2,041
Deferred income taxes	510	381
Refundable income taxes	745	

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	June 30, 2006	Sept. 30, 2005
	<u> </u>	<u> </u>
Prepaid expenses	602	430
Total current assets	13,965	17,135
Property and equipment, net	26,325	26,565
Goodwill	1,855	1,445
Intangible assets, net	572	2,156
Debt issue costs	254	280
Other assets	264	257
Total assets	<u>\$ 43,235</u>	<u>\$ 47,838</u>
 Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	\$ 1,356	\$ 1,681
Accrued expenses	2,286	2,791
Income Taxes Payable		31
Customer advances	4,756	5,974
Revolving line of credit		920
Current portion of capital lease obligation	506	278
Current portion of long-term debt	715	700
Total current liabilities	<u>9,619</u>	<u>12,375</u>
Capital lease obligation, less current portion	1,747	807
Long-term debt, less current portion	8,278	8,579
Subordinated debt, long-term	4,477	4,829
Deferred income taxes	1,189	1,651
Shareholders' equity:		
Preferred shares: Authorized shares - 1,000		
Issued and outstanding shares - none		
Common shares: Authorized shares - 19,000		
Issued and outstanding shares - 4,892 at June 30, 2006		
and 4,871 at September 30, 2005	1,182	1,177
Additional paid-in capital	11,567	11,268
Retained earnings	5,260	7,194
Accumulated other comprehensive loss	(84)	(42)
Total shareholders' equity	<u>17,925</u>	<u>19,597</u>
Total liabilities and shareholders' equity	<u>\$ 43,235</u>	<u>\$ 47,838</u>

See accompanying notes to condensed consolidated financial statements.

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(Unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2006	2005	2006	2005
	(Restated)		(Restated)	
Service revenue	\$ 7,956	\$ 9,078	\$ 25,548	\$ 23,910
Product revenue	2,082	2,226	6,751	6,226
Total revenue	10,038	11,304	32,299	30,136
Cost of service revenue	6,343	5,434	18,965	16,570
Cost of product revenue	1,165	844	2,725	2,352
Total cost of revenue	7,508	6,278	21,690	18,922
Gross profit	2,530	5,026	10,609	11,214
Operating expenses:				
Selling	625	718	2,038	1,919
Research and development	350	261	989	653
General and administrative	3,966	3,115	9,737	7,781
Total operating expenses	4,941	4,094	12,764	10,353
Operating (loss) income	(2,411)	932	(2,155)	861
Interest income	2	2	6	7
Interest expense	(272)	(250)	(780)	(782)
Other income		78		56
Gain on sale of property and equipment		34		21
Income (loss) before income taxes	(2,681)	796	(2,929)	163
Income tax (benefit) expense	(925)	440	(995)	300
Net income (loss)	\$ (1,756)	\$ 356	\$ (1,934)	\$ (137)
Net income (loss) per share:				
Basic	\$ (0.36)	\$ 0.07	\$ (0.40)	\$ (0.03)
Diluted	\$ (0.36)	\$ 0.07	\$ (0.40)	\$ (0.03)
Weighted common and common equivalent shares outstanding:				
Basic	4,892	4,871	4,879	4,870
Diluted	4,892	5,020	4,879	4,870

See accompanying notes to condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended June 30,	
	2006	2005
	(Restated)	
Operating activities		
Net loss	\$ (1,934)	\$ (137)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	3,069	2,462
Impairment of assets	1,100	
Gain on sale of property and equipment		(21)
Employee stock option expense	210	
Deferred income taxes	(591)	
Changes in operating assets and liabilities:		
Accounts receivable	3,587	(5,569)
Inventories	152	(673)
Prepaid expenses and other assets	(194)	(100)
Accounts payable	(325)	(295)
Refundable income taxes	(776)	211
Accrued expenses	(505)	(106)
Customer advances	(1,218)	3,522
Net cash provided (used) by operating activities	2,575	(706)
Investing activities		
Capital expenditures	(1,286)	(1,631)
Proceeds from sale of property and equipment	45	5,887
Net cash provided (used) by investing activities	(1,241)	4,256
Financing activities		
Borrowings on line of credit	11,360	6,968
Payments on line of credit	(12,280)	(9,794)
Exercise of stock options	94	5
Payments on capital lease obligations	(305)	(113)
Payments of long-term debt	(638)	(703)
Net cash used by financing activities	(1,769)	(3,637)
Effects of exchange rate changes	(42)	325
Net increase (decrease) in cash and cash equivalents	(477)	238
Cash and cash equivalents at beginning of period	1,254	773
Cash and cash equivalents at end of period	\$ 777	\$ 1,011

	<u>Nine Months Ended June 30,</u>	
Assets acquired and lease obligations incurred utilizing capital leases	\$ 1,473	\$ 1,112

See accompanying notes to condensed consolidated financial statements.

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BIOANALYTICAL SYSTEMS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Description of the Business and Basis of Presentation

Bioanalytical Systems, Inc. and its subsidiaries (We, the Company or BASi) engage in laboratory services and other services related to pharmaceutical development. We also manufacture scientific instruments for medical research, which we sell with related software for use in industrial, governmental and academic laboratories. Our customers are located throughout the world.

We have prepared the accompanying unaudited interim condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles, and therefore should be read in conjunction with our audited consolidated financial statements, and the notes thereto, for the year ended September 30, 2005. In the opinion of management, the condensed consolidated financial statements for the three and nine months ended June 30, 2006 and 2005 include all adjustments which are necessary for a fair presentation of the results of the interim periods and of our financial position at June 30, 2006. The results of operations for the three and nine months ended June 30, 2006 are not necessarily indicative of the results for the year ending September 30, 2005.

All amounts in the condensed consolidated financial statements and the notes thereto are presented in thousands, except for per share data or where otherwise noted.

2. Error Correction

In our Form 10-Q for the periods ended June 30, 2006 as originally filed, we reported an impairment charge on assets acquired in our 2003 acquisition of PharmaKinetics Laboratories, Inc. of \$968, of which \$383 was applied against goodwill and \$585 was applied against other intangible assets. We subsequently determined that an error had been made in computing the impairment loss as a result of using too low an interest rate in discounting our expected cash flows used to quantify the impairment charge, and the assets to which the charge was allocated. In our restated 10-Q/A for the same periods, we increased our impairment charge to \$1,100 (an increase of \$132 reflected in general and administrative expenses), of which \$383 was applied against goodwill, \$387 was applied against other intangible assets, and \$330 was applied against fixed assets. We also recorded a deferred tax benefit of \$385 as a result of these charges, compared to a benefit of \$251 as originally filed.

The impact on earnings of the above error correction was:

	<u>As Originally Reported</u>	<u>Restated</u>
Net loss:		
Nine months ended June 30, 2006	\$ 1,853	\$ 1,934
Three months ended June 30, 2006	1,675	1,756
Net loss per share (basic and diluted):	\$ 0.38	\$ 0.40

	<u>As Originally Reported</u>	<u>Restated</u>
Nine months ended June 30, 2006		
Three months ended June 30, 2006	0.34	0.36

3. Stock Based Compensation

The Company has an Employee Stock Option Plan whereby options to purchase the Company's common shares at fair market value can be granted to our employees. Options granted vest and become exercisable in four equal installments beginning two years after the date of grant, and expire upon the earlier of the employee's termination of employment with the Company, or ten years from the date of grant. The plan terminates in fiscal 2008.

The Company established an Outside Director Stock Option Plan whereby options to purchase the Company's common shares at fair market value can be granted to outside directors. Options granted vest and become exercisable in four equal installments beginning two years after the date of grant and expire upon the earlier of the director's termination of board service with the Company, or ten years from the date of grant. The plan terminates in fiscal 2008.

On October 1, 2005, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (FAS 123R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors under our stock option plans, based on fair values. Previously, we had not recognized expenses for employee stock options.

We adopted FAS 123R using the modified prospective transition method, which requires the application of the accounting standard as of October 1, 2005, the first day of our fiscal year. Our Condensed Consolidated Financial Statements as of June 30, 2006, and for the three and nine month periods then ended, reflect the impact of FAS 123R. In accordance with the modified prospective transition method, our Condensed Consolidated Financial Statements for prior periods do not include the impact of FAS 123R. Stock-based compensation expense for employee stock options recognized under FAS 123R for the three months and nine months ended June 30, 2006 was \$71 and \$210, respectively. We did not record any tax benefit related to these options.

FAS 123R requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our Statement of Operations. Prior to the adoption of FAS 123R, the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation. Under the intrinsic value method, no stock-based compensation expense had been recognized in the Company's Consolidated Statement of Operations.

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Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is expected to vest during the period, reduced for estimated forfeitures. Stock-based compensation expense recognized in our Condensed Consolidated Statement of Operations for the quarter and nine months ended June 30, 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of October 1, 2005, based on the grant date fair value estimated in accordance with the provisions of FAS 123. There have been no awards granted since the beginning of our fiscal year. Compensation expense for all share-based payment awards are recognized using the straight-line single option approach.

With the adoption of FAS 123R, we continued to use a binomial option-pricing model as our method of valuation for share-based awards. For additional information regarding assumptions used for grants made in periods prior to the current fiscal year, see Note 1(k) to our financial statements in our form 10-K for the year ended September 30, 2005.

Stock based compensation expense recognized in the current fiscal year is the result of grants in prior fiscal years.

The assumptions used in computing our stock based compensation expense for the nine months ended June 30, 2005 were:

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Risk-free interest rate	3.00%
Dividend yield	0.00%
Volatility factor of the expected market price of the Company's common stock	0.668
Expected life of the options (years)	7.0

There were no option grants in any other periods presented.

The following table presents the effect on earnings and earnings per share had we applied the same treatment to stock-based employee compensation in the periods ended June 30, 2005:

	Three Months Ended June 30,	Nine Months Ended June 30,
	2005	2005
Net income (loss) as reported	\$ 356	\$ (137)
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(37)	(130)
Pro forma net income (loss)	\$ 319	\$ (267)
Income (loss) per share:		
Basic and diluted - as reported	\$ 0.07	\$ (0.03)
Basic - pro forma	\$ 0.07	\$ (0.05)
Diluted - pro forma	\$ 0.06	\$ (0.05)

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A summary of our stock option activity and related information for the quarter and nine months ended June 30 is as follows:

	Three Months Ended June 30, 2006		Nine Months Ended June 30, 2006	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding - beginning of period	434	\$ 4.96	480	\$ 4.95
Exercised			(21)	4.50
Granted				
Terminated	(10)	3.32	(35)	4.69
Outstanding - end of period	424	\$ 5.00	424	\$ 5.00

The intrinsic values of options exercised in the nine months ended June 30, 2006 and 2005 were \$37 and \$7 respectively.

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A summary of non vested options for the nine months ended June 30, 2006 is as follows:

	Number	Weighted Average Grant Date Fair Value
Non-vested Shares, beginning of year	343	\$ 4.94
Granted		
Vested	(58)	4.56
Forfeited	(15)	4.67
	270	\$ 5.03

The options on the 424 shares outstanding at June 30, 2006 had an aggregate intrinsic value of \$550 and a weighted average contract term of 7.4 years.

At September 30, 2005 and June 30, 2006, there were 137 and 154 shares vested respectively, all of which were exercisable. At June 30, 2006, the weighted average exercise price for these shares was \$4.95 per share; the aggregate intrinsic value of these shares was \$337 and the weighted average remaining term was 5.8 years.

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4. Intangible Assets and Impairment Loss

In fiscal 2003, we completed the acquisitions of LC Resources, Inc. and PharmaKinetics Laboratories, Inc. (PKLB). In valuing the intangibles acquired, we determined that the replacement cost, in a start-up situation, of establishing these two operations as FDA compliant research sites was \$1,267 and recorded intangible assets of that amount. We determined that these assets had an indeterminate life, and accordingly did not amortize the assets. At the request of the staff of the Securities and Exchange Commission, we have re-examined the make-up of these assets, and have determined that of the total recorded, \$793 related to the hiring and training of the in-place workforce. Financial Accounting Standard 141 requires that such assets be included in goodwill, accordingly we have reclassified that amount to goodwill at June 30, 2006. The remaining \$474 of the intangible asset related to the replacement costs of creating and documenting the operating systems and procedures, their validation and audit. The evolving nature of procedures in a regulated environment requires that we constantly monitor and update those procedures. Accordingly, we have revised our estimate of the useful life of that asset to a ten year life, and recorded amortization in Cost of Services of \$12 in the quarter and \$157 in the nine months ended June 30, 2006.

PKLB, which now constitutes our Baltimore clinical research unit, has experienced losses since acquisition, including \$690 and \$1,980 in the three and nine months ended June 30, 2006, before adjustment. Although improvement had been achieved in operating results since acquisition prior to the current year, the acquisition of a major customer by a company that had other clinical study providers and subsequent cancellation of previously scheduled studies has seriously impacted current operating results. Establishing future profitable operations there will require additional sales effort to attract new customers. Consequently, we have determined that there is a permanent impairment of value of the assets acquired, and have recorded a charge to general and administrative expenses of \$1,100 to write down the value of fixed assets by \$330, and other intangible assets by \$387 and reduced the value of goodwill by \$383 to adjust the values to our estimate of realizable values. The Baltimore clinical research unit is included in the Services segment in footnote 6. We also recorded a deferred tax benefit of \$385 related to this charge.

5. Income (Loss) per Share

We compute basic income or loss per share using the weighted average number of common shares outstanding. We compute diluted income (loss) per share using the weighted average number of common and potential common shares outstanding.

The following table reconciles our computation of basic earnings (loss) per share to diluted earnings (loss) per share:

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	Three Months Ended June 30,		Nine Months Ended June 30,	
	2006	2005	2006	2005
Shares:				
Basic shares	4,892	4,871	4,879	4,870
Effect of dilutive securities				
Options		149		
Convertible subordinated debt				
Diluted shares	4,892	5,020	4,879	4,870
Basic net income (loss)	\$ (1,756)	\$ 356	\$ (1,934)	\$ (137)
Diluted net income (loss)	\$ (1,756)	\$ 356	\$ (1,934)	\$ (137)
Basic earnings (loss) per share	\$ (0.36)	\$ 0.07	\$ (0.40)	\$ (0.03)
Diluted earnings (loss) per share	\$ (0.36)	\$ 0.07	\$ (0.40)	\$ (0.03)

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6. Inventories

Inventories consisted of the following:

	June 30, 2006	September 30, 2005
Raw materials	\$ 1,410	\$ 1,425
Work in progress	271	375
Finished goods	391	424
	2,072	2,224
Less LIFO reserve	(183)	(183)
	\$ 1,889	\$ 2,041

7. Segment Information

We operate in two principal segments – research services and research products. Our Services segment provides research and development support on a contract basis directly to pharmaceutical companies. Our Products segment provides liquid chromatography, electrochemical and physiological monitoring products to pharmaceutical companies, universities, government research centers and medical research institutions. Our accounting policies in these segments are the same as those described in the summary of significant accounting policies.

The following table presents operating results by segment:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2006	2005	2006	2005
Operating income (loss):				

	Three Months Ended June 30,		Nine Months Ended June 30,	
Services	\$ (2,169)	\$ 352	\$ (2,628)	\$ 656
Products	(242)	580	473	205
	<hr/>		<hr/>	
Total operating income (loss)	(2,411)	932	(2,155)	861
Corporate expenses	(270)	(136)	(774)	(698)
	<hr/>		<hr/>	
Income (loss) before income taxes	\$ (2,681)	\$ 796	\$ (2,929)	\$ 163
	<hr/>		<hr/>	

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8. Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that we recognize in our financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of our fiscal year beginning October 1, 2007, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We are currently evaluating the impact of adopting FIN 48 on our financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Form 10-Q may contain forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and/or Section 21E of the Securities Exchange Act of 1934, as amended. Those statements may include, but are not limited to, discussions regarding BASi's intent, belief or current expectations with respect to (i) BASi's strategic plans; (ii) BASi's future profitability; (iii) BASi's capital requirements; (iv) industry trends affecting the Company's financial condition or results of operations; (v) the Company's sales or marketing plans; or (vi) BASi's growth strategy. Investors in BASi's common shares are cautioned that reliance on any forward-looking statement involves risks and uncertainties, including the risk factors contained in Exhibit 99.1 to BASi's annual report on Form 10-K for the year ended September 30, 2005. Although the Company believes that the assumptions on which the forward-looking statements contained herein are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based upon those assumptions also could be incorrect. In light of the uncertainties inherent in any forward-looking statement, the inclusion of a forward-looking statement herein should not be regarded as a representation by the Company that BASi's plans and objectives will be achieved.

GENERAL

The business of Bioanalytical Systems, Inc. is very much dependent on the level of pharmaceutical and biotech companies' efforts in new drug discovery and approval. Our Services segment is the direct beneficiary of these efforts, through their outsourcing of laboratory and analytical needs, and our Products segment is the indirect beneficiary, as increased drug development leads to capital expansion, providing opportunities to sell the equipment we produce and the consumable supplies we provide that support our products.

In our annual report on Form 10-K for the year ended September 30, 2005, we commented on the impacts and anticipated impacts developments in the pharmaceutical industry have on our businesses, as well as some of the potential risks. Those comments are still applicable, and are found under "General" in Part I, Item 2 of that report.

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RESULTS OF OPERATIONS

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The following table summarizes the consolidated statement of operations as a percentage of total revenues:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2006	2005	2006	2005
Service revenue	79.3	80.3	79.1	79.3
Product revenue	20.7	19.7	20.9	20.7
Total revenue	100.0	100.0	100.0	100.0
Cost of service revenue (a)	79.7	59.9	74.2	69.3
Cost of product revenue (a)	56.0	37.9	40.4	37.8
Total cost of revenue	74.8	55.5	67.2	62.8
Gross profit	25.2	44.5	32.8	37.2
Total operating expenses	49.2	36.3	39.5	34.4
Operating income (loss)	(24.0)	8.2	(6.7)	2.8
Other expense	(2.7)	(1.2)	(2.4)	(2.3)
Income (loss) before income taxes	(26.7)	7.0	(9.1)	0.5
Income tax (expense) benefit	9.2	(3.9)	3.1	(1.0)
Net income (loss)	(17.5)	3.1	(6.0)	(0.5)

(a) Percentage of service and product revenues, respectively.

Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005

Service and Product Revenues

Revenues for the third fiscal quarter ended June 30, 2006 declined 11% to \$10.0 million compared to \$11.3 million for the third fiscal quarter last year. Of the \$1.3 million decline, Service revenue decreased \$1.1 million, comprised of decreases of \$1 million each in our Baltimore clinic and our bioanalytical laboratories, offset by a \$1 million increase in our toxicology facility and \$336,000 of new revenues in our pre-clinical pharmacokinetics/pharmacodynamics (PKPD) facility, which began commercial operation this year. The Baltimore clinic was impacted by the acquisition of our largest client for the clinic and subsequent cancellation of its scheduled work, in addition to postponement of a contract pending FDA clearance. Our laboratories experienced a decline in samples processed compared to the prior year when larger contracts resulted in longer production runs, as well as a decline in price per sample due to the nature of the assays. Our toxicology unit continued to experience strong demand for its services, particularly among smaller biotech and discovery clients. Our PKPD unit has experienced good market acceptance of its services, where we employ our proprietary Culex® technology to provide early stage preclinical contract studies for our clients. The decline in product revenue was the result of a decline in Culex® shipments compared to the same quarter last year.

Cost of Revenues

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Cost of revenues for the fiscal quarter ended June 30, 2006 was \$7.5 million or 75% of revenue compared to \$6.3 million, or 56% of revenue for the third fiscal quarter last year. This increase in cost of revenues is a result of several factors. We have experienced increases in our costs in our toxicology and PKPD operations, where we have experienced increased revenues, while maintaining our capabilities in our laboratories and Baltimore clinic in anticipation of restoring activities to prior levels. Additionally, our revenue growth in toxicology resulted in those revenues being a higher proportion of our total revenues, and as a result of a higher percentage cost of revenues in those services than in our laboratory operations, our overall cost of services increased on a percentage basis. Our product costs are up due to increasing sales of consumable products related to our Culex® units, which have lower margins than the units themselves, and to lower utilization of our manufacturing capacity, which results in excess capacity being charged to cost of product revenue. In both our Service and Product Segments, the percentage costs increased relative to sales due to the relatively fixed nature of our costs being carried by a reduced level of sales and increased head count in our production facilities.

Operating Expenses

Selling expenses for the three months ended June 30, 2006 decreased 13% to \$625,000 from \$718,000 for the three months ended June 30, 2005. Our sales expenses declined due to the timing of incidental expenses related to our sales force (year-to-date expenditures are up 6%). Research and development expenses of \$350,000 for the three months ended June 30, 2006 compared to \$261,000 for the three months ended June 30, 2005 and are a result of continuing research on products to support pre-clinical and clinical research.

General and administrative (G&A) for the three months ended June 30, 2006 were impacted by the write-down of assets related to our Baltimore clinical research unit of \$1,100,000 as a result of our determination that those values have been impaired, and by recognition of a bad debt related to the same location of \$231,000. Other items included in G&A expenses for the three months ended June 30, 2006 decreased \$500,000. The principal reasons for this were a reduction of expenses in Baltimore related to our relocated laboratory and cost controls there, coupled with translation expenses charged to G&A in our UK operation last year from a weak pound sterling, compared to translation gains this year.

Other Income/Expense

Interest expense increased 9% to \$272,000 in the three months ended June 30, 2006 from \$250,000 in the comparable quarter of the prior year. This increase is due to our periodic use of our revolving line of credit, which is a floating interest rate that has been consistently higher in the current quarter compared to a year ago, as well as the financing of additional laboratory equipment utilizing capital leases.

Income Taxes

We computed our tax benefit using an effective tax rate for the three months ended June 30, 2006 of 35%. This is the federal rate on our loss in our clinical research unit. We did not provide a state benefit as we have no income or state deferred taxes against which it could be utilized. In the current quarter, we had a profit of \$80,000 on foreign operations for which we have loss carryforwards and therefore provided no taxes, and recorded \$71,000 of stock option expenses for which we took no tax benefit. In the three months ended June 30, 2005 we provided taxes at the rate of 41% on US taxable income, and did not record a benefit for our foreign loss, resulting in an effective tax rate above the statutory rate.

Net Income

As a result of the above factors, we lost \$1,756,000 (\$.36 per share, both basic and diluted) in the quarter ended June 30, 2006, compared to net income of \$356,000 (\$.07 per share, both basic and diluted) in the same period last year.

Nine Months Ended June 30, 2006 Compared to Nine Months Ended June 30, 2005

Service and Product Revenues

Revenues for the nine months ended June 30, 2006 increased 7% to \$32.3 million compared to \$30.1 million for the first nine months of fiscal 2005. Service revenue increases of 7% were the result of an increase in toxicology revenues of \$3 million, new revenues from our PKPD facility of \$850,000, offset by declines in our Baltimore clinic of \$435,000 and declines in our bioanalytical laboratories of \$1.4 million, due to the factors cited above for the current quarter. Revenues for our products increased 8% for the nine months, which was a general increase across our product lines.

Cost of Revenues

Cost of revenues for the nine months ended June 30, 2006 was \$21.7 million or 67% of revenue compared to \$18.9 million, or 63% of revenue for the same period last year. Both the cost of Service revenue and Product revenue increased as a percentage of revenues due to the items cited in the current quarter.

Operating Expenses

Selling expenses for the nine months ended June 30, 2006 increased 6% to \$2.0 million from \$1.9 million for the nine months ended June 30, 2005. This increase is the net of several personnel changes we have made as we endeavor to improve the effectiveness of our sales force. Research and development expenses for the nine months ended June 30, 2006 increased 51% to \$989,000 from \$653,000 for the nine months ended June 30, 2005. This increase is attributable to additional developmental efforts on new products in the current year.

General and administrative expenses for the nine months ended June 30, 2006 increased 25% to \$9.7 million, up from \$7.8 million for the nine months ended June 30, 2005, primarily as a result of the adjustments made in the current quarter mentioned above. Also included in the increase are additional facilities expense in Baltimore of approximately \$250,000 in the current year from the sale/leaseback of the facility in January, 2005, increases in our insurance costs, and the addition of a senior officer in the current year.

Other Income/Expense

Interest expense did not change significantly in the nine months ended June 30, 2006 from the comparable period of the prior year. Lower average borrowing on our revolving line of credit in the current year was offset by additional financing costs of capital leases.

Income Taxes

We computed our benefit for the nine months ended June 30, 2006 using the federal rate of 35% with no state benefit. For the nine months ended June 30, 2005 we used an effective tax rate of 40% on the US taxable income. In that period, we did not provide a benefit on foreign losses because we had no foreign carrybacks or deferred taxes against which to utilize those benefits, which resulted in a disproportionate tax rate.

Net Loss

Our net loss for the nine months ended June 30, 2006 was \$1,934,000 (\$0.40 per share, both basic and diluted). As a result of the taxes on US income exceeding our consolidated income before tax in the nine months ended June 30, 2005, we experienced a net loss of \$137,000 (\$.03 per share, both basic and diluted).

Impairment Charges

Our Baltimore clinical research unit has experienced losses since acquisition, including \$690,000 and \$1,980,000 in the three and nine months ended June 30, 2006, before adjustment. Although improvement had been achieved in operating results since acquisition prior to the current year, the acquisition of a major customer and subsequent cancellation of previously scheduled studies has seriously impacted current operating results. Establishing future profitable operations there will require additional sales effort in attracting new customers. Consequently, in connection with the preparation of our financial statements for the fiscal quarter ended June 30, 2006, we have determined that there is a permanent impairment of value of the assets acquired, and have recorded a charge to general and administrative expenses of \$1,100,000 to write down the value of fixed assets by \$330,000 and other intangible assets by \$387,000 and reduce the value of goodwill by \$383,000 to adjust the values to our estimate of realizable values. We also recorded a deferred tax benefit of \$385,000 related to this charge.

LIQUIDITY AND CAPITAL RESOURCES

Since its inception, BASi's principal sources of cash have been cash flow generated from operations and funds received from bank borrowings and other financings. At June 30, 2006 we had cash of \$777,000, compared to cash of \$1,254,000 at September 30, 2005. Approximately 50% of our cash balances were in the U.K. We monitor our U.K. cash needs to avoid currency conversion costs, which in the current interest rate environment can exceed interest.

Our net cash provided by operating activities was \$2.6 million for the nine months ended June 30, 2006. This was the result of collections against our receivables, and reduced investment in our inventories, offset by working down the balances in customer deposits.

We utilized this cash from operations to finance \$1.3 million of capital asset additions, principally upgrading of facilities in our toxicology and clinical research units. Additionally we repaid \$1.9 million of debt and capital leases during the nine month period. We also financed \$1.5 million of laboratory equipment in the nine months ended June 30, 2006 with capital leases.

Capital Resources

We have outstanding an irrevocable letter of credit issued to secure the lease of our Baltimore facility. The letter of credit is for \$2.0 million currently, reducing to \$1.0 million in January, 2007 and expiring in January, 2008.

The letter of credit reduces the amount of funds available under our \$6 million revolving credit facility. The amount of funds available under this facility is calculated using a borrowing base formula, principally as percentage of qualifying receivables and inventory. Our recent monthly average qualifying assets for our borrowing base have been approximately \$5,000,000.

We do not expect to have any significant additional capital additions in the current fiscal year. We are currently in our planning cycle for our next fiscal year beginning October 1, 2006, and anticipate our additions for next year to be approximately \$2.0 million (none of which has currently been committed). We have not completed arrangements for financing these additions, but anticipate a combination of debt, leasing and utilization of operating cash flow.

Liquidity

We do not foresee the need to borrow extensively under our revolving credit agreement to finance current operations, except for periods when rapid growth of new business may necessitate amounts to finance the buildup of receivables and inventory. Nevertheless, continuation of operating results similar to those experienced in the quarter ended June 30, 2006 would negate our currently positive operating cash flow, and impact our ability to obtain additional financing. Historically, we have experienced significantly varying results from quarter to quarter as a result of the timing of the award and performance of sizable contracts, and we expect that pattern to continue.

At June 30, 2006, we had \$777,000 in cash, and approximately \$3 million of available borrowings under our revolving credit facility.

Our revolving line of credit expires December 31, 2007. The maximum amount available under the terms of the agreement is \$6.0 million with outstanding borrowings limited to the borrowing base as defined in the agreement. Interest accrues monthly on the outstanding balance at the bank's prime rate to prime rate plus 25 basis points, or at the Eurodollar rate plus 250 to 300 basis points, at our election, depending upon the ratio of our interest bearing indebtedness (less subordinated debt) to EBITDA. We pay a fee equal to 25 basis points on the unused portion of the line of credit.

The covenants in the Company's credit agreement, requiring the maintenance of certain ratios of interest bearing indebtedness (not including subordinated debt) to EBITDA and net cash flow to debt servicing requirements, may restrict the amount the Company can borrow to fund future operations, acquisitions and capital expenditures. Based on our current business activities, we believe cash generated from our operations and amounts available under our existing credit facilities and cash on hand, will be sufficient to fund the Company's working capital and capital expenditure requirements for the coming year. As a result of the loss in the three months ended June 30, 2006, we did not meet our fixed charge coverage ratio for the quarter. Our bank has waived this event of non-compliance.

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We are required to make cash payments in the future on debt and lease obligations. The following table summarizes BASi's contractual term debt, lease obligations and other commitments at June 30, 2006 and the effect such obligations are expected to have on our liquidity and cash flows in future periods (amounts presented for 2006 are those items required in the final quarter), for the fiscal years ending September 30 (in thousands):

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>After 2010</u>	<u>Total</u>
Capital expenditures	\$ 250	\$	\$	\$	\$	\$	\$ 250
Mortgage notes payable	86	362	384	407	431	6,963	8,633
Subordinated debt		360	4,359	118			4,837
Capital lease obligations	133	472	510	557	453	128	2,253
Operating leases	527	1,846	387	10			2,770
	<u>\$ 996</u>	<u>\$ 3,040</u>	<u>\$ 5,640</u>	<u>\$ 1,092</u>	<u>\$ 884</u>	<u>\$ 7,091</u>	<u>\$ 18,743</u>

For further details on our indebtedness, see Note 7 to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended September 30, 2005.

AMENDMENT

On August 14, 2006, the Company filed its Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2006 (the "Prior Form 10-Q"), mistakenly believing that its independent accountant, KPMG LLP ("KPMG") had completed the review of the unaudited interim financial information as of and for the three and nine month periods ended June 30, 2006 set forth in the Prior Form 10-Q required by Statement on Auditing Standards No. 100, Interim Financial Statements (the "SAS 100 Review"). On August 15, 2006, KPMG informed the Company that KPMG had not completed its SAS 100 Review of the unaudited interim financial information included in the Prior Form 10-Q prior to the time the Prior Form 10-Q was filed with the U.S. Securities and Exchange Commission. The Company undertook to file an amended Form 10-Q upon completion of KPMG's SAS 100 review. Due to the fact that KPMG's SAS 100 Review had not been completed, the Company advised that the condensed consolidated balance sheets, condensed consolidated statements of operations, condensed consolidated statements of cash flows and notes to condensed consolidated financial statements as of and for the three and nine month periods ended June 30, 2006 included in the Prior Form 10-Q should not be relied upon.

In connection with the completion of KPMG's SAS 100 Review, KPMG and management identified certain material misstatements in connection with the impairment charges related to our Baltimore clinical research unit, as discussed above, and identified certain material weaknesses in our controls and procedures discussed in Item 4, Controls and Procedures, below.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

BASi's primary market risk exposure with regard to financial instruments is changes in interest rates. Borrowings under the credit agreement between BASi and National City Bank dated January 4, 2005 bear interest at a rate of either the bank's prime rate to prime plus 25 basis points, or at the Eurodollar rate plus 250 to 300 basis points, depending in each case upon the ratio of BASi's interest-bearing indebtedness (less subordinated debt) to EBITDA, at BASi's option. We have taken steps to fix the interest rate on a significant amount of our debt through May, 2007. Historically, BASi has not used derivative financial instruments to manage exposure to interest rate changes. BASi estimates that a hypothetical 10% adverse change in interest rates would not affect the consolidated operating results of BASi by a material amount.

BASi operates internationally and is, therefore, subject to potentially adverse movements in foreign currency exchange rates. The effect of movements in the exchange rates was not material to the consolidated operating results of BASi in fiscal years 2006 and 2005. BASi estimates that a hypothetical 10% adverse change in foreign currency exchange rates would not affect the consolidated operating results of BASi by a material amount.

ITEM 4. CONTROLS AND PROCEDURES

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In the initial report on Form 10-Q for the fiscal quarter ended June 30, 2006, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective as of June 30, 2006. Based on their most recent evaluation, and following the review of the letter from the Company's independent accountants, KPMG LLP ("KPMG"), discussed below, the Company's Chief Executive Officer and Chief Financial Officer have now concluded that the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) were not effective, as of June 30, 2006, to ensure that information required to be disclosed by the Company in this Form 10-Q was recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission's rules and forms. This determination is based upon the material weaknesses identified below.

KPMG has presented a letter regarding the following items to the Audit Committee of the Board of Directors, dated August 29, 2006 relating to its review of the unaudited interim financial statements for the Company as of June 30, 2006, and for the three and nine months then ended (the Letter). KPMG noted certain conditions involving the Company's internal control and its operation that KPMG considered to be material weaknesses. Material weakness was defined in the Letter as a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected by the entity's internal control. The material weaknesses noted by KPMG consisted of a failure to set an appropriate "tone at the top" to instill a company-wide attitude of control consciousness; failure to maintain adequate procedures for anticipating and identifying financial reporting risks and for reacting to changes in its operating environment that could have a material effect on financial reporting; failure to maintain adequately trained personnel to perform effective review of accounting procedures critical to financial reporting; and a lack of adequately trained finance and accounting personnel with the ability to apply U.S. generally accepted accounting principles associated with the impairment of certain long-lived assets in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Management concurs with the assessment of KPMG and is currently reviewing its internal controls and procedures.

As a result of the aforementioned material weaknesses in internal control over financial reporting, material misstatements of our current condensed consolidated financial statements occurred and were identified. To correct these errors in accounting, we have filed this Amendment to Quarterly Report on Form 10-Q.

There was no change in the Company's internal control over financial reporting during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1A. RISK FACTORS

In addition to the risk factors disclosed in Exhibit 99 to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2005, the following factor should be considered in evaluating our business and financial condition.

Our independent registered public accounting firm has advised management and our audit committee that they have identified material weaknesses in our internal controls and we have concluded that we have material weaknesses in our disclosure controls and procedures. Our business and stock price may be adversely affected if we do not remediate these material weaknesses or if we have other material weaknesses in our internal controls.

As we disclose in Part I, Item 4, "Controls and Procedures" of this Form 10-Q, our management and independent accountants have concluded that our disclosure controls and procedures were not effective as of June 30, 2006. While we are reviewing and intend to take immediate steps to correct our internal control weaknesses, the material weaknesses that have been discovered will not be considered remediated until new and improved internal controls operate for a period of time, are tested and it is concluded that such new and improved internal controls are operating effectively. Pending the successful completion of such testing, we will identify, develop and perform mitigating procedures relating to our internal control weaknesses.

Any failure to implement and maintain the improvements in the controls over our financial reporting, or difficulties encountered in the implementation of these improvements in our controls, could cause us to fail to meet our reporting obligations. Any failure to improve our internal controls to address the identified material weaknesses could also cause investors to lose confidence in our reported financial information, which could harm our operations or results or cause us to fail to meet our reporting obligations, and could have a negative impact on the trading price of our stock. We cannot be certain that any steps we may take to improve our internal controls to address the identified

material weaknesses will ensure that we implement and maintain adequate controls over our financial processes and reporting in the future.

ITEM 5. OTHER INFORMATION

In connection with the preparation of our financial statements for the fiscal quarter ended June 30, 2006, we concluded that there is a permanent impairment of value of the assets of one of the companies we acquired, and have recorded a charge to general and administrative expenses of \$1,100,000 to write down the value of fixed assets by \$330,000 and other intangible assets by \$387,000, and reduce the value of goodwill by \$383,000. We also recorded a deferred tax benefit of \$385,000 related to this charge. Pursuant to the instructions to Item 2.06 of Form 8-K, the information required by such Item is included in the Management's Discussion and Analysis of Financial Condition and Results of Operations above. Please see the heading Results of Operations - Impairment Loss on Intangible Assets and Goodwill, which information is incorporated herein by this reference.

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ITEM 6. EXHIBITS

Exhibits

Number assigned
in Regulation S-K
Item 601

Description of Exhibits

- | | | |
|------|------|---|
| (3) | 3.1 | Second Amended and Restated Articles of Incorporation of Bioanalytical Systems, Inc. (incorporated by reference to Exhibit 3.1 to Form 10-Q for the quarter ended December 31, 1997). |
| | 3.2 | Second Restated Bylaws of Bioanalytical Systems, Inc. (incorporated by reference to Exhibit 3.2 Form 10-Q for the quarter ended December 31, 1997). |
| (4) | 4.1 | Specimen Certificate for Common Shares (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-1, Registration No. 333-36429). |
| (31) | 31.1 | Certification of Richard M. Shepperd + |
| | 31.2 | Certification of Michael R. Cox + |
| (32) | 32.1 | Section 1350 Certifications + |
| (99) | 99.1 | Risk factors (incorporated by reference to Exhibit 99.1 to Form 10-K for the year ended September 30, 2005). |

Filed with this Quarterly Report on Form 10-Q.

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SIGNATURES

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

BIOANALYTICAL SYSTEMS, INC.

By: /s/ RICHARD M. SHEPPERD

Richard M. Shepperd
President and Chief Executive
Officer (Principal Executive Officer)

Date: November 1, 2006

By: /s/ MICHAEL R. COX

Michael R. Cox
Vice President-Finance and Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: November 1, 2006