

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.**  
(State or other jurisdiction of  
incorporation or organization)

**41-1719250**  
(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  NO

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

YES  NO

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  NO

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**Certification of CEO and CFO Pursuant to Section 906**

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## PART I. FINANCIAL INFORMATION

**ITEM 1. FINANCIAL STATEMENTS**UROPLASTY, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

	<b>June 30, 2006</b> <b>(unaudited)</b>	<b>March 31,</b> <b>2006</b>
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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CONSOLIDATED BALANCE SHEETS

	<b>June 30, 2006</b> <b>(unaudited)</b>	<b>March 31,</b> <b>2006</b>
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)

	<b>Three Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
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)

	<b>Three Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
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)

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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:

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

**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.

	<b>Estimated Lives (Years)</b>	<b>Gross Carrying Amount</b>	<b>June 30, 2006</b>	
			<b>Accumulated Amortization</b>	<b>Net value</b>
Licensed technology	5	\$ 501,290	\$ 136,028	\$ 365,262
Patents and inventions	6	237,900	218,095	19,805
<b>Totals</b>		<b>\$ 739,190</b>	<b>\$ 354,123</b>	<b>\$ 385,067</b>
			<b>March 31, 2006</b>	
Licensed technology	5	\$ 501,290	\$ 111,183	\$ 390,107
Patents and inventions	6	237,900	216,403	21,497
<b>Totals</b>		<b>\$ 739,190</b>	<b>\$ 327,586</b>	<b>\$ 411,604</b>

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
	<b>\$ 385,100</b>

**6. Comprehensive Loss**

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

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	<b>Three Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
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:

	<b>Number of Options/Warrants</b>	<b>Range of Exercise Prices</b>
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.





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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).

	<b>As Reported</b>		<b>Proforma Under APB 25</b>
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.

	<b>Three Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
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	100.26%
Expected dividend yield	0
Weighted-average fair value	2.177

The expected life selected for options granted during the quarter represents the period of time that we expect our options to be outstanding based on historical data of option holder exercise and termination behavior for similar grants. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury rate over the expected life at the time of grant. Expected volatilities are based upon historical volatility of our stock. As of June 30, 2006, we had approximately \$ 644,461 of unrecognized compensation cost related to share-based payments that we expect to recognize over a weighted-average period of 1.75 years.

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The following table summarizes activity related to our stock options during the three months ended June 30, 2006:

	<b>Number of Shares</b>	<b>Weighted Avg Exercise Price</b>	<b>Weighted Avg Remaining Contract Life</b>
Options outstanding at beginning of period	1,888,327	\$ 3.80	4.48
Options granted	358,000	2.51	8.86
Options exercised	(9,666)	1.32	
Options surrendered	(22,267)	5.13	
Options outstanding at end of period	2,214,394	\$ 3.59	5.27
Options exercisable at end of period	1,820,310	\$ 3.86	4.97

**10. Savings and Retirement Plans**

We sponsor various plans for eligible employees in the United States, the United Kingdom (UK), and The Netherlands. Our retirement savings plan in the United States conforms to Section 401(k) of the Internal Revenue Code and participation is available to substantially all employees. We may also make discretionary contributions ratably to all eligible employees. We made no discretionary contributions in association with these plans in the United States for the quarters ended June 30, 2006 and 2005, respectively.

Our international subsidiaries have defined benefit retirement plans for eligible employees. These plans provide benefits based on each employee's years of service and compensation during the years immediately preceding retirement, termination, disability, or death, as defined in the plans. We invest pension plan assets in insurance contracts. We closed the defined benefit plan in The Netherlands for new employees effective April 2005. As of that date, our Dutch subsidiary established a defined contribution plan. We froze our UK subsidiary's defined benefit plan on December 31, 2004. On March 10, 2005, our UK subsidiary established a defined contribution plan.

The cost for our defined benefit retirement plans in The Netherlands and the United Kingdom includes the following components for the periods ended June 30, 2006 and 2005:

	<b>Three Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Gross service cost	\$ 50,542	\$ 44,861
Interest cost	30,413	25,835
Expected return on assets	(17,444)	(14,911)
Amortization	10,431	7,267
Net periodic retirement cost	\$ 73,942	\$ 63,052

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Major assumptions used in the above calculations include:

	<b>Three Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
Discount rate	4.25-5.50%	4.50-5.25%
Expected return on assets	4.00-5.00%	4.00-5.00%
Expected rate of increase in future compensation:		
General	3%	3%
Individual	0%-3%	0%-3%

**11. Foreign Currency Translation**

We translate all assets and liabilities using period-end exchange rates. We translate statements of operations items using average exchange rates for the period. We record the resulting translation adjustment within accumulated other comprehensive loss, a separate component of shareholders' equity. We recognize foreign currency transaction gains and losses in our consolidated statements of operations, including unrealized gains and losses on short-term intercompany obligations using period-end exchange rates. We recognize unrealized gains and losses on long-term intercompany obligations within accumulated other comprehensive loss, a separate component of shareholders' equity. We recognize exchange gains and losses primarily as a result of fluctuations in currency rates between the U.S. dollar (the functional reporting currency) and the euro and British pound (currencies of our subsidiaries), as well as their effect on the dollar denominated intercompany obligations between us and our foreign subsidiaries. All intercompany balances are revolving in nature and we do not deem them to be long-term balances. For the three months ended June 30, 2006 and 2005, we recognized foreign currency gain (loss) of \$26,411 and \$(1,199), respectively.

**12. Income Tax Expense**

During the quarters ended June 30, 2006 and 2005, our Dutch subsidiaries recorded income tax expense of \$30,751 and \$37,020, respectively. We cannot use our U.S. net operating loss carry forwards to offset taxable income in foreign jurisdictions.

**13. Business Segment and Geographic Information**

We sell proprietary products for the treatment of voiding dysfunctions. Our current primary product is Macroplastique®, a soft tissue bulking material used for the treatment of urinary incontinence and vesicoureteral reflux. In addition, we market soft tissue bulking material for additional indications, including the treatment of vocal cord rehabilitation, fecal incontinence and soft tissue dermal augmentation. At this time, all sales for the tissue bulking agent products are outside the United States. The Macroplastique product line accounted for 59% and 70%, respectively, of total net sales for the three-months ended June 30, 2006 and 2005, respectively.

The 510(k) premarket clearance from U.S. Food and Drug Administration (FDA) for the I-STOP polypropylene, tension-free, mid-urethral sling for the treatment of female urinary incontinence was received in August 2005. We have exclusive distribution rights for this product in the United States and the United Kingdom. In October 2005, we received U.S. FDA 510(k) premarket clearance for our Urgent® PC Neuromodulation System, a minimally invasive nerve stimulation device designed for office-based treatment of overactive bladder symptoms of urge incontinence, urinary urgency and urinary frequency. We started selling the Urgent PC device in November 2005 in the United States and in December 2005 in Europe and Canada. The Urgent PC is also indicated for the treatment of fecal incontinence outside the United States. In July 2006, we received U.S. FDA 510(k) premarket clearance for our enhanced version of the Urgent PC. In addition, we are a distributor of specialized wound care products in The Netherlands and United Kingdom.

Based upon the above, we operate in only one reportable segment consisting of medical products primarily for the urology market.

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Information regarding operations in different geographies for the three months ended June 30, 2006 and 2005 is as follows:

	United States	The Netherlands	United Kingdom	Adjustments and Eliminations	Consolidated
<b>Fiscal 2007</b>					
Sales, three months ended June 30, 2006	\$ 298,300	\$1,163,129	\$529,437	\$(226,656)	\$ 1,764,210
Income tax expense, three months ended June 30, 2006		30,751			30,751
Net income (loss), three months ended June 30, 2006	(1,347,945)	107,927	(57,675)	56,454	(1,241,239)
Long-lived assets at June 30, 2006	1,079,198	747,365	4,282		1,830,845
<b>Fiscal 2006</b>					
Sales, three months ended June 30, 2005	\$ 140,821	\$1,337,601	\$457,770	\$(290,539)	\$ 1,645,653
Income tax expense, three months ended June 30, 2005		37,020			37,020
Net income (loss), three months ended June 30, 2005	(1,656,475)	(12,104)	44,414	161,852	(1,462,313)
Long-lived assets at June 30, 2005	619,125	741,071	7,398		1,367,594

**14. Recently Issued Accounting Standards**

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement 109 ( FIN 48 ), which clarifies the accounting for uncertainty in tax positions. This Interpretation provides that the tax effects from an uncertain tax position can be recognized in our financial statements, only if the 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 the beginning of fiscal 2008, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We are currently evaluating the impact, if any, of adopting FIN 48 on our consolidated financial statements.

**15. Subsequent Event**

In August 2006, we entered into a securities purchase agreement with certain investors pursuant to which we sold 1.4 million shares of our common stock for \$1.50 per share, together with warrants to purchase 695,000 shares of our common stock, for an aggregate proceeds of \$2.1 million. After offset for our estimated costs of \$183,000, we received net proceeds of \$1.9 million. The warrants are exercisable for 5 years (but commencing 181 days after closing) at an exercise price of \$2.50 per share.

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

We recommend that you read this Report on Form 10-QSB in conjunction with our Annual Report on Form 10-KSB for the year ended March 31, 2006.

**Forward-looking Statements**

We may from time to time make written or oral forward-looking statements, including our statements contained in this filing with the Securities and Exchange Commission and in our reports to stockholders, as well as elsewhere. Forward-looking statements are statements such as those contained in projections, plans, objectives, estimates, statements of future economic performance, and assumptions related to any of the foregoing, and may be identified by the use of forward-looking terminology, such as may, expect, anticipate, estimate, goal, continue, or other similar terminology. By their very nature, forward-looking statements are subject to known and unknown risks and uncertainties relating to our future performance that may cause our actual results, performance, or achievements, or industry results, to differ materially from those expressed or implied in any such forward-looking statements. Any such statement is qualified by reference to the following cautionary statements.

Our business operates in highly competitive markets and is subject to changes in general economic conditions, competition, customer and market preferences, government regulation, the impact of tax regulation, foreign exchange rate fluctuations, the degree of market acceptance of products, the uncertainties of potential litigation, as well as other risks and uncertainties detailed elsewhere herein and from time to time in our Securities and Exchange Commission filings.

In this filing, the section entitled Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements. Various factors and risks (not all of which are identifiable at this time) could cause our results, performance, or achievements to differ materially from that contained in our forward-looking statements, and investors are cautioned that any forward-looking statement contained herein or elsewhere is qualified by and subject to the warnings and cautionary statements contained above and in our other filings with the Securities and Exchange Commission.

We do not undertake, nor assume obligation, to update any forward-looking statement that we may make from time to time.

**Overview**

We are a medical device company that develops, manufactures and markets innovative, proprietary products for the treatment of voiding dysfunctions. We have developed, and are developing, minimally invasive products primarily for the treatment of urinary and fecal incontinence and overactive bladder symptoms. All products we currently sell are CE marked for European Union clearance. In the U.S. we have received 510(k) clearance for two of our products (I-STOP and Urgent PC). Our Macroplastique and other implantable tissue bulking products have not been cleared for marketing in the United States. We are pursuing FDA pre-market approval (PMA) for our Macroplastique product. We sell our products in approximately 40 countries.

Our goal is to develop and commercialize a portfolio of minimally invasive products for the treatment of voiding dysfunctions. We believe that, with a suite of innovative products, we can increasingly garner the attention of key physicians and distributors and enhance market acceptance of our products. The key elements of our strategy are to:

Pursue regulatory approval in the U.S. for our Macroplastique products.

Expand our U.S. marketing and sales organization, using a combination of direct and independent reps;

Conduct multi-center, prospective, post-market clinical trials for the Urgent PC;

Expand distribution of our products outside of the U.S.; and

Acquire or license complimentary products if appropriate opportunities arise.

We concluded a multi-center human clinical trial using Macroplastique Implants in a minimally invasive, office-based procedure for treating adult female stress urinary incontinence resulting from intrinsic sphincter deficiency, a

weakening of the muscles that control the flow of urine from the bladder. In December 2004, the FDA accepted for filing our pre-market approval submission with respect to Macroplastique for the treatment of female stress urinary incontinence. This submission is under review by the FDA and we continue to expect, as we indicated in July 2005, the possible approval by the FDA in 2007. We will incur substantial expenses in connection with these regulatory activities. Even if we obtain regulatory approval, it may be only for limited uses with specific classes of patients, which may limit the market for our product.

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In the United States, we recently staffed our sales organization, consisting of a direct field sales management team and independent sales representatives, and a marketing organization to market our products directly to our customers. We anticipate further increasing, as needed, our sales and marketing organization in the United States to support our sales growth. Outside of the United States, we sell our products primarily through a direct and independent sales organization in the United Kingdom and primarily through distributors in other markets. Our sales and marketing activities require significant ongoing expenditures.

**Critical Accounting Policies**

We prepare our consolidated financial statements in accordance with U.S. generally accepted accounting principles, which require us to make estimates and assumptions in certain circumstances that affect amounts reported. In preparing these consolidated financial statements, we have made our best estimates and judgments of certain amounts, giving due consideration to materiality. We believe that of our significant accounting policies, the following are particularly important to the portrayal of our results of operations and financial position. They may require the application of a higher level of judgment by Uroplasty management, and as a result are subject to an inherent degree of uncertainty.

*Revenue Recognition.* The Securities and Exchange Commission's Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition in Financial Statements, provides guidance on the application of generally accepted accounting principles to selected revenue recognition issues. We believe our revenue recognition policies comply with SAB 104. We market and distribute our products primarily through our direct and independent sales organization in the United States and the United Kingdom, and primarily through distributors in our other markets. We recognize revenue upon shipment of product to our distributors and direct customers. We have no customer acceptance provisions or installation obligations. Our sales terms to our distributors and customers provide no right of return outside of our standard warranty, and payment terms consistent with industry standards apply. Sales terms and pricing to our distributors are governed by the respective distribution agreements. Our distribution partners purchase the Uroplasty products to meet sales demand of their end-user customers as well as to fulfill their internal requirements associated with the sales process and, if applicable, contractual purchase requirements under the respective distribution agreements. Internal and other requirements include purchases of products for training, demonstration and evaluation purposes, clinical evaluations, product support, establishing inventories, and meeting minimum purchase commitments. As a result, the level of our net sales during any period is not necessarily indicative of our distributors' sales to end-user customers during that period, which we estimate are not substantially different than our sales to those distributors in each of the last two years. Our distributors' level of inventories of our products, their sales to end-user customers and their internal product requirements may impact our future revenue growth.

*Accounts Receivable.* We carry our accounts receivable at the original invoice amount less an estimate made for doubtful receivables based on a periodic review of all outstanding amounts. We determine the allowance for doubtful accounts based on customer health, and both historical and expected credit loss experience. We write off our accounts receivable when we deem them uncollectible. We record recoveries of accounts receivable previously written off when received.

*Inventories.* We state inventories at the lower of cost or market using the first-in, first-out method. We provide lower of cost or market reserves for slow moving and obsolete inventories based upon current and expected future product sales and the expected impact of product transitions or modifications. While we expect our sales to grow, a reduction in sales could reduce the demand for our products and may require additional inventory reserves.

*Foreign Currency Translation/Transactions.* The financial statements of our foreign subsidiaries were translated in accordance with the provisions of SFAS No. 52 Foreign Currency Translation. Under this Statement, we translate all assets and liabilities using period-end exchange rates, and we translate statements of operations items using average exchange rates for the period. We record the resulting translation adjustment within accumulated other comprehensive loss, a separate component of shareholders' equity. We recognize foreign currency transaction gains and losses in the statement of operations, including unrealized gains and losses on short-term intercompany obligations using period-end exchange rates, resulting in an increase in the volatility of our consolidated statements of operations. We recognize unrealized gains and losses on long-term intercompany obligations within accumulated other comprehensive loss, a separate component of shareholders' equity.



*Impairment of Long-Lived Assets.* Long-lived assets at June 30, 2006 consist of property, plant and equipment and intangible assets. We review our long-lived assets for impairment whenever events or business circumstances indicate that the carrying amount of an asset may not be recoverable. We measure the recoverability of assets to be held and used by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If we consider such assets impaired, we measure the impairment to be recognized by the amount by which the carrying amount of the assets exceeds the fair value of the assets. We report assets to be disposed of at the lower of the carrying amount or fair value less costs to sell.

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*Share-Based Compensation.* In December 2004, FASB published Statement No. 123 (revised 2004), *Share-Based Payment* ( SFAS 123(R) or the Statement ). SFAS 123(R) requires that we recognize the compensation cost relating to share-based payment transactions, including grants of employee stock options, in our financial statements. We must measure that cost based on the fair value of the equity or liability instruments issued. SFAS 123(R) covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS 123(R) is a replacement of Statement No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB 25, and its related interpretive guidance. This Statement requires us to measure the cost of employee services received in exchange for stock options based on the grant-date fair value of the award, and to recognize the cost over the period we require our employee to provide services for the award. FAS 123(R) permits us to use any option-pricing model that meets the fair value objective in the Statement. We adopted FAS 123(R) for the first time in the first quarter of fiscal year 2007. FAS 123(R) allows two methods for determining the effects of the transition: the modified prospective and the modified retrospective. We have adopted the modified prospective transition method beginning April 1, 2006. We calculated the pro forma compensation costs presented previously and in our prior filings using a Black-Scholes option pricing model. These compensation costs may not be indicative of amounts which we will incur in future years.

*Income Taxes.* We recognize deferred tax assets and liabilities for future tax consequences attributable to differences between the financial carrying amounts of existing assets and liabilities and their respective tax bases. We measure deferred tax assets and liabilities using enacted tax rates we expect to apply to taxable income in the years in which we expect to recover or settle those temporary differences. We have generated approximately \$15,423,000 in U.S. net operating loss carryforwards that we cannot use to offset taxable income in foreign jurisdictions. We recognize a valuation allowance when we determine it is more likely than not that we will not realize a portion of the deferred tax asset. We have established a valuation allowance for U.S. and certain foreign deferred tax assets due to the uncertainty that we will generate enough income in those taxing jurisdictions to utilize the assets.

In addition, U.S. tax rules impose limitations on the use of net operating loss following certain changes in ownership. Such a change in ownership may limit the amount of these benefits that would be available to offset future taxable income each year, starting with the year of ownership change.

Set forth below is management's discussion and analysis of the financial condition and results of operations for the three-months ended June 30, 2006 and 2005.

**Results of Operations****Three-month period ended June 30, 2006 compared to three-month period ended June 30, 2005**

**Net Sales:** In the first quarter ended June 30, 2006, net sales were \$1.8 million, representing an \$119,000 or 7% increase when compared to net sales of \$1.6 million for the quarter ended June 30, 2005. Excluding the impact of fluctuations in foreign currency exchange rates, sales increased by approximately 4%. A 9% decline in sales of Macroplastique products was more than offset by sales of the Urgent PC and an increase in sales of the I-STOP. In the first quarter ended June 30, 2005, we had no sales of the Urgent PC and had minimal sales of the I-STOP.

We attribute the decline in sales of the Macroplastique products primarily due to adverse changes in the reimbursement policies of the insurers and the increase in pricing competition. We expect this to adversely impact our future sales in those markets. In response, we have implemented targeted volume price reductions, have stepped up training workshops targeted to our sales personnel, distributors and key incontinence surgeons, and are sponsoring scientific podium presentations and seminars at key international incontinence congresses. We cannot assure that these initiatives will increase Macroplastique sales.

**Gross Profit:** Gross profit was \$1.2 million for both quarters ended June 30, 2006 and 2005, or 69% and 74% of net sales in the respective periods. We attribute the decline in gross profit percent primarily to lower manufacturing capacity utilization due to decline in Macroplastique sales, duplicate manufacturing facilities in the U.S. pending completion of our relocation to our new corporate headquarters, higher costs for our new facility and an increase in personnel-related costs. We expect to relocate the remaining operations to our new corporate headquarters in the third quarter of our current fiscal year after quality and regulatory qualifications of our new manufacturing facility.

General and Administrative Expenses (G&A): G&A expenses increased from \$691,000 during the first quarter of fiscal 2006 to \$884,000 during the first quarter of fiscal 2007. Included in the fiscal 2007 first quarter is a \$266,000 non-cash, SFAS 123(R) charge for share-based employee compensation. Excluding this charge, G&A expenses declined by \$73,000, primarily because fiscal 2005 first quarter contained certain charges related to the installation of our new information system.

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**Research and Development Expenses (R&D):** R&D expenses increased from \$631,000 during the first quarter of fiscal 2006 to \$675,000 during the first quarter of fiscal 2007. Included in the fiscal 2007 first quarter is an \$11,000 non-cash, SFAS 123(R) charge for share-based employee compensation. Excluding this charge, R&D expenses increased by \$33,000. We attribute the increase primarily to the increase in spending for clinical trials and testing.

**Selling and Marketing Expenses (S&M):** S&M expenses increased from \$664,000 during the first quarter of fiscal 2006 to \$1,233,000 during the first quarter of fiscal 2007. Included in the fiscal 2007 first quarter is a \$22,000 non-cash, SFAS 123(R) charge for share-based employee compensation. Excluding this charge, S&M expenses increased by \$547,000. We attribute the increase to the \$360,000 increase in compensation-related costs, primarily for our U.S. direct sales force and marketing organization, \$110,000 for increase in travel-related costs and an increase in other costs to support our expanded organization and marketing activities.

**Other Income (Expense):** Other income (expense) includes interest income, interest expense, warrant expense or benefit, foreign currency exchange gains and losses and other non-operating costs when incurred. Our financial results are subject to material fluctuations based on changes in currency exchange rates. Other income (expense) was \$372,000 and \$(665,000) for the first quarters ended June 30, 2006 and 2005, respectively.

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 will be 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. The Company 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 for the three months ended June 30, 2006 and a warrant expense of \$686,000 for 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.

We recognize exchange gains and losses primarily as a result of fluctuations in currency rates between the U.S. dollar (the functional reporting currency) and the euro and British pound (currencies of our subsidiaries), as well as their effect on the dollar denominated short-term intercompany obligations between us and our foreign subsidiaries. We recognized foreign currency gains (losses) of \$26,000 and \$(1,000) for the first quarters ended June 30, 2006 and 2005, respectively.

**Income Tax Expense:** Our Dutch subsidiaries recorded income tax expense of \$31,000 and \$37,000 for the quarters ended June 30, 2006 and 2005, respectively. For fiscal 2007, the Dutch income tax rate is 25.5% for 22,689 (approximately \$29,000) of profit and 29.6% for amounts above 22,689 compared to 27% and 31.5% in fiscal 2006, respectively.

**Non-GAAP Financial Measures.** In addition to disclosing financial results calculated in accordance with U.S. generally accepted accounting principles (GAAP), our discussion of the results of operations above contains non-GAAP financial measures that exclude the effects of share-based compensation and the requirements of FAS 123(R). The non-GAAP financial measures used by management and disclosed by us exclude the income statement effects of share-based compensation and the effects of FAS 123(R). The non-GAAP financial measures disclosed by us should not be considered a substitute for, or superior to, financial measures calculated in accordance with GAAP, and the consolidated financial results calculated in accordance with GAAP and reconciliations to those financial statements should be carefully evaluated. We may calculate our non-GAAP financial measures differently from similarly titled measures used by other companies. Therefore, our non-GAAP financial measures may not be comparable to those used by other companies. We have described the reconciliations of each of our non-GAAP financial measures above to the most directly comparable GAAP financial measures.

Because we excluded FAS 123(R) compensation expense in some of our discussion above, these financial measures are treated as a non-GAAP financial measure under Securities and Exchange Commission rules. Management uses our non-GAAP financial measures for internal managerial purposes, including as a means to compare period-to-period

results on a consolidated basis and as a means to evaluate our results on a consolidated basis compared to those of other companies.

We disclose this information to the public to enable investors who wish to more easily assess our performance on the same basis applied by management and to ease comparison on both a GAAP and non-GAAP basis among peer companies.

**Liquidity and Capital Resources**

*Cash Flows.* As of June 30, 2006, our cash and cash equivalents balances totalling \$1.4 million.

At June 30, 2006, we had working capital of approximately \$1.9 million. During the three months ended of fiscal 2007, we used \$1.1 million of cash in operating activities, compared to \$870,000 of cash used in the same period of fiscal 2006. The usage of cash over the three months was primarily attributable to the net loss incurred of \$1.2 million and fluctuations in accounts receivable, other current assets, accounts payable and accrued expenses, due to the timing of payments and fluctuations in foreign currency exchange rates.

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Fluctuations in foreign currency exchange rates, weak economic conditions in foreign markets where we sell and distribute our products, changes in regulatory environment and changes in third-party reimbursement policies could materially affect our financial condition and results of operations. The effects of these conditions could include reduced unit sales and reduced sales in dollars when converted from foreign currency amounts and material gains and losses on transactions denominated in foreign currencies. Furthermore, because our U.S. operations are funded by sales denominated in foreign currency, strengthening of the U.S. dollar against the euro and/or the British pound could have an adverse effect on our cash flow and results of operations.

*Sources of Liquidity.* In April 2005, we conducted a private placement in which we sold 2,147,142 shares of our common stock at a price per share of \$3.50, together with warrants to purchase 1,180,928 shares of our common stock, for an aggregate purchase price of approximately \$7.5 million. The stock sale proceeds are offset by costs of approximately \$935,000, resulting in net proceeds of approximately \$6.6 million. The warrants are exercisable for five years at an exercise price of \$4.75 per share.

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 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 equity declines below \$0.5 million. We may borrow the maximum \$1 million only if our consolidated equity is not less than \$1 million. For consolidated equity in excess of \$0.5 million but less than \$1 million, the maximum that can be borrowed is \$250,000. The bank charges interest on the loan at the rate of 1 percentage point over the prime rate, subject to a minimum interest rate of 7% 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. At June 30, 2006, we had no borrowings under any of our credit lines.

In May 2006, we also entered into a \$100,000 3-year, term loan agreement with Venture Bank, at an interest rate of 8.25% per annum. The amount is used for certain capital expenditures relating to the relocation of our facility to our Minnetonka, Minnesota location.

In August 2006, we entered into a securities purchase agreement with certain investors pursuant to which we sold approximately 1.4 million shares of our common stock for \$1.50 per share, together with warrants to purchase 695,000 shares of our common stock, for an aggregate proceeds of approximately \$2.1 million. After offset for our estimated costs of \$183,000, we received net proceeds of \$1.9 million. The warrants are exercisable for 5 years (but commencing 181 days after closing) at an exercise price of \$2.50 per share.

*Commitments and Contingencies.* We believe that our current resources, funds generated from sale of our products, proceeds from the August 2006 private placement together with the credit facilities will be adequate to meet our cash flow needs, including regulatory activities associated with existing products, through the end of the fiscal year. 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 to fund our operations and grow our business. As such we will need to raise additional equity capital, but there can be no guarantee that we will be successful.

We expect to continue to incur significant costs for regulatory activities associated with obtaining regulatory approval in the United States for Macroplastique. For fiscal 2007, we expect to incur significant research and development expenses, including those in connection with the regulatory approval activities for Macroplastique and clinical trials for the Urgent PC. We also expect that during fiscal 2007, we will continue to incur significant expenses as we expand our selling and marketing organization in the U.S. to market our products. In addition, we expect general and administrative expenses in fiscal 2007 to increase as we increasingly prepare to implement the provisions of Section 404 of the Sarbanes-Oxley Act of 2002.

In April 2005, we entered into an exclusive manufacturing and distribution agreement with CystoMedix for the Urgent PC product. The agreement required us to pay CystoMedix an initial payment of \$225,000 and an additional payment of \$250,000 in 12 monthly installments of \$20,833, with the last installment payment made in the first quarter of fiscal 2007. We capitalized the aggregate amount as licensed technology and are amortizing it over the term of the agreement. We will also pay CystoMedix a 7% royalty on product sales. However, the 7% royalty is first offset against the monthly royalty installments. Currently we do not project making any additional royalty payments to

CystoMedix in fiscal 2007.

CystoMedix has also granted us an exclusive option to acquire its assets. The purchase price is \$3,485,000, reduced by up to \$50,000 of liabilities assumed by us. However, the \$3,485,000 amount used to compute the purchase price will increase at a rate of 10% per year after April 2007. The purchase price is payable in shares of our common stock valued at the average of the closing bid price of our shares for the 20 trading days prior to our exercise of the option. We may exercise the option until June 2008. If we exercise the option, we will also assume up to \$1.4 million of bridge loan advances made to CystoMedix by its Chairman. We would repay up to \$1.1 million of the bridge loan advances at closing and would issue our common stock for the balance of the bridge loan based on the above option price. We also have certain rights of first refusal to acquire CystoMedix's assets in the event CystoMedix receives a third party offer in advance of any exercise of our option. We will need to raise additional equity or debt funds in order to consummate the CystoMedix acquisition, should we elect to do so.

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We have two exclusive distribution agreements with CL Medical allowing us to market and sell the I-STOP urethral sling: effective February 2006, a six-year agreement, with a right to renew it for successive five-year terms, for distribution in the United States and, effective May 2005, a one-year agreement with automatic renewal for up to two years, for distribution in the United Kingdom. Under the agreements, we are required to purchase a minimum of \$630,000 of units in the first 12-month period following January 1, 2006, increasing to \$2.6 million of units in the fifth year of the agreement, for an aggregate commitment of approximately \$6.7 million of units over the five-year period, subject to periodic adjustment based on the value of the euro.

We are obligated to pay royalties of 5% of net sales of Macroplastique products in the U.S. with a minimum of \$50,000 per year. The duration of this royalty agreement is through May 1, 2006. Under another royalty agreement we pay royalties, in the aggregate, of three to five percent of net sales of Macroplastique, Bioplastique, and PTQ Implants subject to a monthly minimum of \$4,500. The royalties payable under this agreement will continue until the patent referenced in the agreement expires in 2010. Under a license agreement for the Macroplastique Implantation System, we pay a royalty of 10 British pounds for each unit sold during the life of the patent.

We have a pension plan covering 16 employees in The Netherlands, reported as a defined benefit plan. We pay premiums to an insurance company to fund annuities for these employees. However, we are responsible for funding additional annuities based on continued service and future salary increases. We closed this defined benefit plan for new employees in April 2005. As of that date, the Dutch subsidiary established a defined contribution plan that now covers new employees. We also closed our UK subsidiary's defined benefit plan to further accrual for all employees effective December 31, 2004. In March 2005, the UK subsidiary established a defined contribution plan that now covers new employees.

In January 2006, we entered into a long-term lease with Liberty Property Limited Partnership for an 18,258 square foot facility for our U.S. headquarters located at 5420 Feltl Road, Minnetonka, Minnesota. The lease effective date was May 1, 2006, has a term of 96 months, requires average annual minimum rent payments of approximately \$140,000 and requires payments for operating expenses estimated to be approximately \$82,000 in the first 12 months.



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Repayments of our contractual obligations as of June 30, 2006, consisting of royalties, notes payable (inclusive of interest), and operating leases, are summarized below:

	<b>Total</b>	<b>Payments Due by Period</b>			
		<b>Remainder of Fiscal 2007</b>	<b>Fiscal 2008 and 2009</b>	<b>Fiscal 2010 and 2011</b>	<b>Fiscal 2012 and thereafter</b>
Minimum royalty payments	\$ 234,000	\$ 40,500	\$ 108,000	\$ 85,500	\$
Minimum purchase agreement	6,996,482	721,696	2,129,973	4,144,813	
Notes payable	756,607	165,980	193,478	107,869	289,280
Operating lease commitments	1,367,331	242,763	401,668	285,773	437,127
<b>Total contractual obligations</b>	<b>\$ 9,264,782</b>	<b>\$ 1,081,301</b>	<b>\$ 2,833,119</b>	<b>\$ 4,623,955</b>	<b>\$ 726,407</b>

**ITEM 3. CONTROLS AND PROCEDURES.**

**Disclosure Controls and Procedures.** Within the 90 days prior to the date of this report, our President and Chief Executive Officer and Chief Financial Officer carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15b under the Securities Exchange Act of 1934. Based on this evaluation, these officers concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

**Internal Control Matters.** We also maintain a system of internal accounting controls designed to provide reasonable assurance that our books and records accurately reflect our transactions and that our policies and procedures are followed. There have been no changes in our internal control over financial reporting during the quarter ended June 30, 2006, or thereafter, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Any control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The design of a control system inherently has limitations, and the benefits of controls must be weighed against their costs. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. Therefore, no evaluation of a cost-effective system of controls can provide absolute assurance that all control issues and instances of fraud, if any, will be detected.

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**PART II. OTHER INFORMATION**

Except as indicated below, none of the items contained in PART II of Form 10-QSB are applicable to us for the three months ended June 30, 2006.

**ITEM 1. LEGAL PROCEEDINGS**

None.

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

On May 3, 2006, we held a special meeting of our shareholders. At the meeting, the shareholders approved our 2006 stock and incentive plan. A summary of the voting is as follows:

Votes For	Votes Against	Votes Withheld	Abstentions and Broker Non-Votes
3,133,014	998,270		2,185,763

**ITEM 6. EXHIBITS.**

(a) Exhibits

31.1 Certifications by the Chief Executive Officer and the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certifications by the Chief Executive Officer and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (this Exhibit is furnished pursuant to SEC rules, but is deemed not filed )

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**SIGNATURES**

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

UROPLASTY, INC.

by: /s/ DAVID B. KAYSEN

Date: August 14, 2006

David B. Kaysen  
President and Chief Executive Officer

Date: August 14, 2006

by: /s/ MAHEDI A. JIWANI

Mahedi A. Jiwani  
Chief Financial Officer  
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