ABAXIS INC
Form 10-Q
November 09, 2006

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

FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended September 30, 2006

OR

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number 000-19720

ABAXIS, INC.

(Exact name of registrant as specified in its charter)

California	**77-0213001**
(State of Incorporation)	*(I.R.S. Employer Identification No.)*

3240 Whipple Road
Union City, California 94587
(Address of principal executive offices)

(510) 675-6500
(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
x	o

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. (Check one):

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o

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

Yes	No
o	x

As of November 6, 2006, there were 20,761,000 shares of the Registrant s common stock outstanding.

ABAXIS, INC.
Quarterly Report on Form 10-Q
For the Quarter Ended September 30, 2006

TABLE OF CONTENTS

PART I: FINANCIAL INFORMATION

Item 1. Condensed Financial Statements (Unaudited)

Abaxis, Inc.
Condensed Statements of Operations
(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2006	2005	2006	2005
Revenues	$ 21,037,000	$ 17,413,000	$ 41,395,000	$ 31,686,000
Cost of revenues (1)	9,479,000	7,321,000	18,400,000	13,767,000
Gross profit	11,558,000	10,092,000	22,995,000	17,919,000
Operating expenses:				
Research and development (1)	1,519,000	1,431,000	3,236,000	3,063,000
Sales and marketing (1)	5,533,000	3,814,000	10,004,000	7,035,000
General and administrative (1)	1,386,000	1,378,000	2,970,000	2,832,000
Total operating expenses	8,438,000	6,623,000	16,210,000	12,930,000
Income from operations	3,120,000	3,469,000	6,785,000	4,989,000
Interest and other income	394,000	181,000	734,000	247,000
Interest and other expense	(27,000)		(31,000)	(13,000)
Income before income taxes	3,487,000	3,650,000	7,488,000	5,223,000
Income tax provision	1,373,000	1,352,000	2,973,000	1,924,000
Net income	$ 2,114,000	$ 2,298,000	$ 4,515,000	$ 3,299,000
Net income per share:				
Basic net income per share	$ 0.10	$ 0.12	$ 0.22	$ 0.17
Diluted net income per share	$ 0.10	$ 0.11	$ 0.21	$ 0.16
Shares used in the calculation of net income per share:				
Weighted average common shares outstanding - basic	20,605,000	19,920,000	20,437,000	19,909,000
Weighted average common shares outstanding - diluted	21,968,000	21,321,000	21,890,000	21,235,000
Share-based compensation expense by function (1)				
Cost of revenues	$ 6,000		$ 26,000	
Research and development	31,000		58,000	
Sales and marketing	76,000		153,000	
General and administrative	84,000		150,000	
Total share-based compensation expense	$ 197,000		$ 387,000	

(1) Cost of revenues and operating expenses for the three and six months ended September 30, 2006 include share-based compensation expense in accordance with Statement of Financial Accounting Standards No. 123(R), which the Company adopted on April 1, 2006. See Note 6 to the

unaudited condensed financial statements for additional information.
See notes to the unaudited condensed financial statements.

Abaxis, Inc.
Condensed Balance Sheets
(Unaudited)

	September 30, 2006	March 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 13,227,000	$ 10,164,000
Short-term investments	26,870,000	20,372,000
Trade receivables (net of allowances of $376,000 at September 30, 2006 and $343,000 at March 31, 2006)	14,800,000	14,638,000
Inventories	11,455,000	10,396,000
Prepaid expenses	680,000	446,000
Net deferred tax asset - current	4,254,000	4,294,000
Total current assets	71,286,000	60,310,000
Property and equipment, net	11,286,000	10,038,000
Intangible assets, net	487,000	525,000
Deposits and other assets	60,000	80,000
Net deferred tax asset - non-current	9,395,000	12,125,000
Total assets	$ 92,514,000	$ 83,078,000
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 6,064,000	$ 4,614,000
Accrued payroll and related expenses	3,644,000	3,890,000
Other accrued liabilities	989,000	705,000
Warranty reserve	313,000	213,000
Deferred revenue	846,000	939,000
Total current liabilities	11,856,000	10,361,000
Deferred rent	428,000	478,000
Deferred revenue, less current portion	936,000	938,000
Other long-term liabilities	265,000	263,000
Total non-current liabilities	1,629,000	1,679,000
Commitments and contingencies (Note 5)		
Shareholders equity:		
Preferred stock, no par value: authorized shares - 5,000,000; no shares issued and outstanding		
Common stock, no par value: authorized shares - 35,000,000; issued and outstanding shares - 20,711,000 at September 30, 2006 and 20,135,000 at March 31, 2006	99,922,000	96,506,000
Accumulated deficit	(21,028,000)	(25,543,000)
Accumulated other comprehensive income	135,000	75,000
Total shareholders equity	79,029,000	71,038,000
Total liabilities and shareholders equity	$ 92,514,000	$ 83,078,000

See notes to the unaudited condensed financial statements.

Abaxis, Inc.
Condensed Statements of Cash Flows
(Unaudited)

	Six Months Ended September 30,	
	2006	**2005**
Operating activities:		
Net income	$ 4,515,000	$ 3,299,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,253,000	1,041,000
Loss on disposal of property and equipment	29,000	
Share-based compensation expense	387,000	(12,000)
Tax benefit from exercises of share-based payment awards		56,000
Common stock issued for employee benefit plans	66,000	43,000
Changes in assets and liabilities:		
Trade receivables	(162,000)	(1,281,000)
Inventories	(1,024,000)	(389,000)
Prepaid expenses	(234,000)	(9,000)
Net deferred tax asset - current		1,632,000
Deposits and other assets	20,000	12,000
Net deferred tax asset - non-current	2,730,000	(11,000)
Accounts payable	1,450,000	(110,000)
Accrued payroll and related expenses	(246,000)	1,090,000
Other accrued liabilities	284,000	332,000
Warranty reserve	100,000	(57,000)
Deferred rent	(50,000)	13,000
Deferred revenue	(95,000)	(87,000)
Other long-term liabilities	2,000	124,000
Net cash provided by operating activities	9,025,000	5,686,000
Investing activities:		
Purchases of short-term investments	(39,177,000)	(13,857,000)
Proceeds from maturities of short-term investments	32,779,000	13,787,000
Purchases of property and equipment	(2,510,000)	(1,568,000)
Net cash used in investing activities	(8,908,000)	(1,638,000)
Financing activities:		
Repayment of capital lease obligations		(10,000)
Proceeds from the exercise of common stock options and warrants	2,946,000	275,000
Net cash provided by financing activities	2,946,000	265,000
Net increase in cash and cash equivalents	3,063,000	4,313,000
Cash and cash equivalents at beginning of period	10,164,000	5,776,000
Cash and cash equivalents at end of period	$ 13,227,000	$ 10,089,000
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 4,000	$ 1,000
Cash paid for income taxes, net of refunds	$ 216,000	$ 189,000
Supplemental disclosure of non-cash information:		
Change in unrealized gains on short-term investments, net of tax	$ 60,000	$ 90,000

See notes to the unaudited condensed financial statements.

Abaxis, Inc.
Notes to the Condensed Financial Statements
(Unaudited)

Note 1. Summary of Significant Accounting Policies

Description of Business-Abaxis, Inc. (the Company) was incorporated in California in 1989 for the purpose of developing, manufacturing and marketing portable blood analysis systems for use in any veterinary or human patient-care setting to provide clinicians with rapid blood constituent measurements.

Basis of Presentation- The unaudited condensed financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. These unaudited condensed financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2006. The unaudited condensed financial statements included herein reflect all normal recurring adjustments, which are, in the opinion of management, necessary to state fairly the results of operations and financial position for the periods presented. The results for the periods ended September 30, 2006 are not necessarily indicative of the results to be expected for the entire fiscal year ending March 31, 2007 or for any future period.

Reclassifications- Certain reclassifications have been made to prior periods financial statements to conform to the current period presentation. These reclassifications had no material impact on previously reported results of operations.

Use of Estimates in Preparation of Financial Statements- The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Such management estimates include allowance for doubtful accounts, sales and other allowances, inventory reserves, a valuation allowance for net deferred tax assets and warranty reserves. Actual results could differ from those estimates.

Recent Accounting Pronouncements

SFAS No. 123(R)

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)). SFAS No. 123(R) is a revision of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123) and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure An Amendment of FASB No. 123 and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25). During 2005, the FASB also issued Staff Positions No. FAS 123(R)-1, -2, and -3 to provide application guidance related to SFAS No. 123(R). SFAS No. 123(R) requires all share-based compensation to employees and directors to be valued at fair value on the date of grant, and to be expensed over the applicable vesting period.

Prior to April 1, 2006, the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB No. 25 and other related guidance and therefore, no employee compensation cost had been recognized for stock-based awards in financial statements prior to fiscal 2007 because the Company issued stock options with an exercise price equal to the market value at the date of grant.

On April 1, 2006, the Company adopted SFAS No. 123(R) using the modified prospective method and accordingly, prior period financial statements have not been restated to reflect the impact of SFAS No. 123(R). SFAS No. 123(R) requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including stock options and restricted stock units based on their fair values, in its results of operations. The share-based compensation expense includes expense for unvested awards at March 31, 2006 and all awards granted subsequent to March 31, 2006. Share-based compensation expense for the unvested awards outstanding at March 31, 2006 is based on the grant-date fair value as used in calculating the pro forma disclosures in prior period financial statements in accordance with the provisions of SFAS No. 123. The impact of the adoption of SFAS No. 123(R) on the Company s financial results is disclosed in Note 6.

FIN 48

In June 2006, the FASB issued FASB Interpretation 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (SFAS No. 109). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109 and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 will be effective for the Company on April 1, 2007. The Company is currently evaluating FIN 48 and has not determined the expected impact of the implementation of the pronouncement on its financial position, cash flows and results of operations.

SFAS No. 157

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157), which clarifies the definition of fair value, establishes guidelines for measuring fair value and expands financial statement disclosures regarding fair value measurements. SFAS No. 157 will be effective for the Company on April 1, 2008. The Company is currently evaluating the impact of adopting SFAS No. 157 on its financial position, cash flows and results of operations.

SAB No. 108

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB No. 108). SAB No. 108 provides guidance on the consideration of effects of the prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. The SEC staff believes registrants must quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB No. 108 is effective for the Company in its fiscal year ended March 31, 2007. The Company is currently assessing SAB No. 108 and its effect on the Company s financial position, cash flows and results of operations.

Note 2. Inventories

Inventories, net, include material, labor and overhead, and are stated at the lower of cost (first-in, first-out method) or market. Components of inventories, net, are as follows:

	September 30, 2006	March 31, 2006
Raw materials	$ 5,886,000	$ 5,581,000
Work-in-process	2,672,000	2,904,000
Finished goods	2,897,000	1,911,000
	$ 11,455,000	$ 10,396,000

Note 3. Warranty Reserves

The Company provides for the estimated future costs to be incurred under the Company s standard warranty obligation of two years. Estimated contractual warranty obligations are recorded when related sales are recognized and any additional amounts are recorded when such costs are probable and can be reasonably estimated.

The change in the Company s accrued warranty reserve during the three and six months ended September 30, 2006 and 2005 is summarized as follows:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2006	2005	2006	2005
Balance at beginning of period	$ 491,000	$ 318,000	$ 472,000	$ 245,000
Provision for warranty expense	142,000	39,000	197,000	160,000
Warranty costs incurred	(55,000)	(40,000)	(91,000)	(88,000)
Balance at end of period	578,000	317,000	578,000	317,000
Long-term portion of warranty reserve	265,000	129,000	265,000	129,000
Current portion of warranty reserve	$ 313,000	$ 188,000	$ 313,000	$ 188,000

Note 4. Line of Credit

The Company has a line of credit with Comerica Bank-California which provides for borrowings of up to $2,000,000. The line of credit terminates upon notification by either party and the outstanding balance is payable upon demand. The line of credit bears interest at the bank s prime rate minus 0.25%, which totaled 8.00% at September 30, 2006, and is payable monthly. Of the $2,000,000 available, $410,000 was committed to secure a letter of credit for the Company s facilities lease at September 30, 2006. At September 30, 2006, there was no amount outstanding under the Company s line of credit. The weighted average interest rates on the line of credit during the three months ended September 30, 2006 and 2005 were 8.00% and 6.17%, respectively.

The line of credit agreement contains certain financial covenants, which are evaluated on a quarterly basis. Included in these financial covenants, among other stipulations, is a requirement that the Company has a minimum net income of $25,000 before preferred stock dividends and accretion in any three quarters of a fiscal year, provided that any loss before preferred stock dividends and accretion on preferred stock incurred in the remaining quarter is not to exceed $250,000. The Company is also required to be profitable, as defined, on a fiscal year to date basis beginning with the six months period ending September 30, 2006 and to have net income before preferred stock dividends and accretion on preferred stock of $1,150,000 for the fiscal year ending March 31, 2007. In addition, the Company is required to have a quick ratio, as defined, of not less than 2.00 to 1.00, cash flow coverage, as defined, of not less than 1.25 to 1.00, debt to net worth ratio, as defined, not greater than 1.00 to 1.00 and to maintain a tangible effective net worth, as defined, of not less than $25,731,000. At September 30, 2006, the Company was in compliance with these covenants.

Borrowings under the line of credit are collateralized by the Company s net book value of assets of $79.0 million at September 30, 2006, including its intellectual property.

Note 5. Commitments and Contingencies

In November 2003, the Company entered into an original equipment manufacturing (OEM) agreement with Diatron Messtechnik GmbH (DIATRON) of Austria to purchase DIATRON hematology instruments. The DIATRON hematology instruments are currently supplied by Diatron MI Kft. Under the terms of this agreement, the Company became committed to purchase a minimum number of hematology units through fiscal 2009 from DIATRON once the product was qualified for sale, which occurred in May 2004. In September 2006, the terms of the agreement, with respect to the purchase commitments, were revised. Under the amended agreement, the Company is committed to purchase a minimum number of hematology units through fiscal 2008. At September 30, 2006, the outstanding commitment totaled $6,922,000. The payments due for fiscal years 2007 and 2008 were $3,461,000 and $3,461,000, respectively.

The Company is involved from time to time in various litigation matters in the normal course of business. The Company believes that the ultimate resolution of these matters will not have a material effect on its financial position or results of operations.

Note 6. Share-Based Compensation

Equity Compensation Plans

The Company s share-based compensation plans are described below.

2005 Equity Incentive Plan The Company s 2005 Equity Incentive Plan (the Equity Incentive Plan), restated and amended the Company s 1998 Stock Option Plan. The Equity Incentive Plan allows for the awards of stock options, stock appreciation rights, stock awards (stock purchase rights and stock bonuses), restricted stock units, performance shares, performance units, other stock-based awards and cash-based awards to employees, directors and consultants. The Equity Incentive Plan provides for the issuance of a maximum of 4,886,000 shares, of which 584,154 shares of common stock were available for issuance as of September 30, 2006.

Options granted to employees and directors generally expire ten years from the grant date. Options granted to employees generally become exercisable over a period of four years based on cliff-vesting terms and continuous employment. Options granted to non-employee directors generally become exercisable over a period of one year based on monthly vesting terms and continuous service. See the Stock Options section in this Note for additional information.

Restricted stock units awarded to employees generally vest over a period of four years and the awards are also subject to accelerated vesting upon achieving certain performance-based milestones and continuous employment during the vesting period. Restricted stock units awarded to non-employee directors vest in full one year after grant date based on continuous service. See the Restricted Stock Units section in this Note for additional information.

1992 Outside Directors Stock Option Plan Under the Company s 1992 Outside Directors Stock Option Plan (the Directors Plan), options to purchase shares of common stock were automatically granted, annually, to non-employee directors. Options under the Directors Plan were nonqualified stock options and were granted at the fair market value on the date of grant and expired ten years from the date of grant. Options granted to directors generally become exercisable over a period of one year based on monthly vesting terms and continuous service. The Directors Plan provided for the issuance of a maximum of 250,000 shares. As of September 30, 2006, no shares of common stock were available for issuance because the time period for granting options expired in accordance with the terms of the Directors Plan in June 2002.

Impact of the Adoption of SFAS No. 123(R) on Financial Results

Non-cash compensation expense recognized for share-based awards totaled $197,000 and $387,000 during the three and six months ended September 30, 2006, respectively. Share-based compensation expense reduced basic and diluted net income per share by $0.01 and $0.01, respectively, during the three months ended September 30, 2006. Share-based compensation expense reduced basic and diluted net income per share by $0.02 and $0.01, respectively, during the six months ended September 30, 2006. The total unrecognized compensation expense for unvested share-based compensation awards outstanding at September 30, 2006 amounted to $6,086,000, which is expected to be recognized over the subsequent four years. Capitalized share-based compensation cost at September 30, 2006 was $17,000, which was included in inventory on the balance sheet.

Cash proceeds from the exercise of stock options for the three months ended September 30, 2006 and 2005 were $734,000 and $176,000, respectively. Cash proceeds from the exercise of stock options for the six months ended September 30, 2006 and 2005 were $2,860,000 and $222,000, respectively. Prior to the adoption of SFAS No. 123(R), the Company presented all tax benefits for deductions resulting from the exercise of stock options as operating cash flows on its statement of cash flows. SFAS No. 123(R) requires the cash flows resulting from the excess tax benefits for those share-based payment awards to be classified as financing cash flows. There were no excess tax benefits recorded for the three and six months ended September 30, 2006.

Pro Forma Information for Periods Prior to the Adoption of SFAS No. 123(R)

As discussed in Note 1, the Company accounted for share-based employee compensation under SFAS No. 123(R) s fair value method during the six months ended September 30, 2006. The Company s financial statements prior to April 1, 2006 do not include the impact of recording stock options using the fair value. During the three and six months ended September 30, 2005, in accordance with the provisions of SFAS No. 123, the fair value of each stock option was estimated on the date of the grant using the Black-Scholes option pricing model, based on a multiple option valuation approach, and forfeitures were recognized as they occurred.

The following table illustrates the effect on the Company s pro forma net income and basic and diluted net income per share using the fair value-based accounting method in the three and six months ended September 30, 2005:

	Three Months Ended September 30, 2005	Six Months Ended September 30, 2005
Net income, as reported	$ 2,298,000	$ 3,299,000
Less pro forma share-based compensation expense determined under the fair value-based accounting method for all awards, net of related tax effects	(480,000)	(1,037,000)
Pro forma net income	$ 1,818,000	$ 2,262,000
Basic and diluted net income per share:		
As reported - basic	$ 0.12	$ 0.17
Pro forma - basic	$ 0.09	$ 0.11
As reported - diluted	$ 0.11	$ 0.16
Pro forma - diluted	$ 0.09	$ 0.11

Stock Options

Prior to April 1, 2006, the Company granted stock options to employees, with an exercise price equal to the closing market price of the Company s common stock on the date of grant and with cliff-vesting terms over four years, conditional on continuous employment. The Company s current practice is to issue new shares of common stock upon the exercise of stock options. There were no stock options granted during the three and six months ended September 30, 2006 and during the three months ended September 30, 2005.

In the pro forma disclosures in prior period financial statements, the fair value of each stock option granted was estimated on the date of the grant using the Black-Scholes option pricing model, based on a multiple option valuation approach, and forfeitures were recognized as they occurred. For these unvested awards as of March 31, 2006, the Company has continued to recognize compensation expense based on the estimated grant date fair value method using the Black-Scholes option pricing model. In accordance with the provisions of SFAS No. 123(R), the compensation expense is reduced for an estimate of the number of stock option awards that are expected to be forfeited. The forfeiture estimate is based on historical data and other factors, and compensation expense is adjusted for actual results. The following are the weighted average assumptions used to determine the fair value of each stock option on the date of grant:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2006	2005	2006	2005
Expected life of option	N/A	N/A	N/A	6 years
Risk-free interest rate	N/A	N/A	N/A	3.76%
Dividend yield	N/A	N/A	N/A	0.00%
Volatility	N/A	N/A	N/A	53%

As of September 30, 2006, the total unrecognized compensation expense related to stock options granted amounted to $332,000, which is expected to be recognized over a weighted average period of one year.

The following table summarizes information regarding stock options outstanding and exercisable at September 30, 2006 and the changes during the six-month period then ended:

	Options Outstanding			Options Exercisable	
	Number of Shares Outstanding	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (Years)	Number of Shares Exercisable	Weighted Average Exercise Price Per Share
Balance at March 31, 2006	2,532,000	$ 6.77	4.79	2,317,000	$ 6.61
Granted					
Exercised	(541,000)	5.29			
Canceled or forfeited	(5,000)	12.17			
Balance at September 30, 2006	1,986,000	$ 7.16	4.80	1,850,000	$ 7.00

The aggregate intrinsic value of options outstanding and exercisable at September 30, 2006 was $32,225,000 and $30,332,000, respectively. The intrinsic value represents the pre-tax intrinsic value, based on the Company s closing stock price as of September 29, 2006, (the last trading day for the quarterly period ended September 30, 2006), which would have been received by the option holders had all option holders exercised their options as of that date. During the three and six months ended September 30, 2006, the total intrinsic value of stock options exercised was $2,472,000 and $8,225,000, respectively.

The following table summarizes information regarding stock options outstanding and exercisable at September 30, 2006:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Shares Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price Per Share	Number of Shares Exercisable	Weighted Average Exercise Price Per Share
$ 1.50 - $ 2.13	222,000	2.27	$ 1.68	222,000	$ 1.68
$ 2.25 - $ 3.00	208,000	2.79	2.59	208,000	2.59
$ 3.12 - $ 3.13	54,000	1.00	3.12	54,000	3.12
$ 3.20 - $ 3.85	284,000	6.55	3.84	233,000	3.84
$ 3.94 - $ 4.75	53,000	4.68	4.30	53,000	4.30
$ 4.87 - $ 4.87	374,000	4.56	4.87	374,000	4.87
$ 4.94 - $ 7.56	249,000	4.11	6.40	247,000	6.40
$ 7.88 - $ 12.99	206,000	4.80	9.04	168,000	8.55
$ 13.00 - $ 21.45	116,000	7.76	15.43	71,000	16.06
$ 21.65 - $ 22.10	220,000	7.55	21.66	220,000	21.66
$ 1.50 - $ 22.10	1,986,000	4.80	$ 7.16	1,850,000	$ 7.00

Stock Option Acceleration On December 5, 2005, the Board of Directors approved full acceleration of unvested stock options with an exercise price of $19.12 or greater previously granted under the Abaxis, Inc. 1998 Stock Option Plan held by Company officers and employees. Options to purchase 144,810 shares of the Company s common stock, including 126,873 shares held by the Company s executive officers, became immediately exercisable as of December 5, 2005.

Restricted Stock Units

The Company grants restricted stock unit awards to employees and directors as part of its share-based compensation program beginning in fiscal 2007. The restricted stock unit awards entitle holders to receive shares of common stock at the end of a specified period of time. Vesting for restricted stock unit awards is based on continued employment or service of the holder. Upon vesting, the equivalent number of common shares are typically issued net of tax withholdings. If the vesting conditions are not met, unvested restricted stock unit awards will be forfeited. Generally, the restricted stock unit awards vest according to one of the following vesting schedules:

Restricted stock unit awards to employees Four year time-based vesting as follows: 5 percent vesting after first year; additional 10 percent after the second year; additional 15 percent after the third year; and the remaining 70 percent after the fourth year. Additionally, the restricted stock unit awards are also subject to accelerated vesting upon achieving certain performance-based milestones.

Restricted stock unit awards to non-employee directors - 100 percent vesting after one year.

The Compensation Committee, in its discretion, may provide in the event of a change in control for the acceleration of vesting and/or settlement of the restricted stock unit held by a participant upon such conditions and to such extent as determined by the Compensation Committee. It is currently anticipated that awards granted to executive officers will accelerate fully on a change of control. The vesting of non-employee director awards granted under the Equity Incentive Plan automatically will accelerate in full upon a change in control.

The following table summarizes information regarding the activity for restricted stock units during the six months ended September 30, 2006:

	Number of Shares	Weighted Average Grant Date Fair Value
Unvested at March 31, 2006		$
Granted	305,000	24.56
Vested		
Forfeited	(2,000)	21.43
Unvested at September 30, 2006	303,000	$ 24.58

The weighted average grant date fair value of restricted stock units is based on the closing market price of the Company s common stock on the date of grant. The weighted average fair value of restricted stock unit awards granted during the three months ended September 30, 2006 was $21.52 per share.

The fair value of restricted stock unit awards is measured on the date of grant based on the number of shares granted and the closing market price of the Company s common stock. Such value is recognized as an expense over the corresponding requisite service period. The share-based compensation expense is reduced for an estimate of the restricted stock unit awards that are expected to be forfeited. The forfeiture estimate is based on historical data and other factors, and compensation expense is adjusted for actual results. As of September 30, 2006, the total unrecognized compensation expense related to restricted stock unit awards granted amounted to $5,754,000, which is expected to be recognized over a weighted average period of 3.06 years.

Note 7. Net Income Per Share

Basic net income per share is computed by dividing the net income attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income attributable to common shareholders by the weighted average number of common shares that would have been outstanding during the period assuming the issuance of common shares for all potential dilutive common shares outstanding.

The following is a reconciliation of the weighted average number of common shares outstanding used in calculating basic and diluted net income per share:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2006	2005	2006	2005
Numerator:				
Net income	$ 2,114,000	$ 2,298,000	$ 4,515,000	$ 3,299,000
Denominator:				
Weighted average common shares outstanding - basic	20,605,000	19,920,000	20,437,000	19,909,000
Weighted average effect of dilutive securities:				
Stock options	1,223,000	1,276,000	1,313,000	1,215,000
Restricted stock units	4,000		1,000	
Warrants	136,000	125,000	139,000	111,000
Weighted average common shares outstanding - diluted	21,968,000	21,321,000	21,890,000	21,235,000
Net income per share:				
Basic net income per share	$ 0.10	$ 0.12	$ 0.22	$ 0.17
Diluted net income per share	$ 0.10	$ 0.11	$ 0.21	$ 0.16

The Company excluded the following stock options and warrants from the computation of diluted weighted average shares outstanding if the exercise price of the stock options and warrants is greater than the average market price of the Company s common stock because the inclusion of these stock options and warrants would be antidilutive to net income per share:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2006	2005	2006	2005
Weighted average number of shares underlying antidilutive stock options and warrants		414,000	5,000	432,000
Weighted average exercise price per share underlying antidilutive stock options and warrants	$	$ 18.52	$ 22.10	$ 18.30

The Company excluded the following restricted stock units from the computation of diluted weighted average shares outstanding because the inclusion of these awards would be antidilutive to net income per share:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2006	2005	2006	2005
Weighted average number of shares underlying antidilutive restricted stock units	212,000	N/A	184,000	N/A

Note 8. Income Taxes

The Company s effective tax rate was 39% and 37% for the three months ended September 30, 2006 and 2005, respectively. The Company s effective tax rate was 40% and 37% for the six months ended September 30, 2006 and 2005, respectively. The increase in the effective tax rate for the three and six months ended September 30, 2006, as compared to the three and six months ended September 30, 2005, was due to non-deductible share-based compensation expense and the expiration of the federal research and development tax credit.

Tax Effects of Stock Awards

In November 2005, FASB issued Financial Statement Position (FSP) on SFAS 123(R)-3, Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards. Effective upon issuance, this FSP describes an alternative transition method for calculating the tax effects of stock-based compensation pursuant to SFAS No. 123(R). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and the statement of cash flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS No. 123(R). Companies have one year from the later of the adoption of SFAS No. 123(R) or the effective date of the FSP to evaluate their transition alternatives and make a one-time election. The Company expects to make such election by the end of fiscal 2007.

Note 9. Comprehensive Income

The following is a summary of comprehensive income for the three and six months ended September 30, 2006 and 2005:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2006	2005	2006	2005
Net income	$ 2,114,000	$ 2,298,000	$ 4,515,000	$ 3,299,000
Other comprehensive income:				
Change in unrealized gains on short-term investments, net of tax	4,000	31,000	60,000	90,000
Comprehensive income	$ 2,118,000	$ 2,329,000	$ 4,575,000	$ 3,389,000

Note 10. Revenues by Product Category, Customer Group and Geographic Region and Significant Concentrations

The Company currently operates in one segment, the development, manufacturing, marketing and sales of portable blood analysis systems for use in any veterinary or human patient-care setting to clinicians with rapid blood constituent measurement requirements.

Revenue Information

The following is a summary of revenues for each group of products and services provided by the Company:

	Three Months Ended September 30,		Six Months Ended September 30,	
Revenues by Product Category	2006	2005	2006	2005
Instruments	$ 6,568,000	$ 5,133,000	$ 13,298,000	$ 9,076,000
Reagent discs and kits	12,280,000	10,606,000	24,390,000	20,050,000
Other	1,688,000	1,071,000	2,764,000	1,922,000
Product sales, net	20,536,000	16,810,000	40,452,000	31,048,000
Development and licensing revenue	501,000	603,000	943,000	638,000
Total revenues	$ 21,037,000	$ 17,413,000	$ 41,395,000	$ 31,686,000

The following is a summary of revenues by customer group:

	Three Months Ended September 30,		Six Months Ended September 30,	
Revenues by Customer Group	2006	2005	2006	2005
Medical Market	$ 4,120,000	$ 3,347,000	$ 7,850,000	$ 5,021,000
Veterinary Market	15,160,000	12,713,000	30,701,000	24,719,000
Other	1,757,000	1,353,000	2,844,000	1,946,000
Total revenues	$ 21,037,000	$ 17,413,000	$ 41,395,000	$ 31,686,000

The following is a summary of revenues by geographic region based on customer location:

	Three Months Ended September 30,	Six Months Ended September 30,

Revenues by Geographic Region	2006	2005	2006	2005
North America	$ 17,668,000	$ 14,951,000	$ 34,431,000	$ 27,038,000
Europe	2,319,000	1,800,000	4,762,000	3,484,000
Asia and Latin America	1,050,000	662,000	2,202,000	1,164,000
Total revenues	$ 21,037,000	$ 17,413,000	$ 41,395,000	$ 31,686,000

Significant Concentrations

Revenues from significant customers as a percentage of total revenue were as follows:

Distributor	Geographical Location	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Six Months Ended September 30, 2006	Six Months Ended September 30, 2005
Walco International, Inc., d/b/a DVM Resources	United States	16%	14%	16%	16%
Henry Schein, Inc.	United States		16%		15%
Total		16%	30%	16%	31%

At September 30, 2006, one distributor in the United States accounted for 19% of trade receivables. At September 30, 2005, two distributors in the United States accounted for 21% and 11%, respectively, of trade receivables.

Substantially all of the Company s long-lived assets are located in the United States.

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

Forward-Looking Statements

This Management s Discussion and Analysis of Financial Condition and Results of Operations includes a number of forward-looking statements, which reflect Abaxis current views with respect to future events and financial performance. In this report, the words will, anticipates, believes, expects, future, intends, plans, and similar expressions identify forward-looking statements. These forward-looking statements are subject to certain risks and uncertainties, including but not limited to those discussed below, in Part II, Item 1A of this report and in our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission, that could cause actual results to differ materially from historical results or those anticipated. Such risks and uncertainties include the market acceptance of our products and the continuing development of our products, required United States Food and Drug Administration clearance and other government approvals, risks associated with manufacturing and distributing our products on a commercial scale, free of defects, risks related to the introduction of new instruments manufactured by third parties, risks associated with entering the human diagnostic market on a larger scale, risks related to the protection of the Abaxis intellectual property or claims of infringement of intellectual property asserted by third parties, risks involved in carrying of inventory, risks associated with the ability to attract, train and retain competent sales personnel, general market conditions and competition. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Abaxis assumes no obligation to update any forward-looking statements as circumstances change.

Business Overview

Abaxis, Inc. (Abaxis, us or we), incorporated in California in 1989, develops, manufactures and markets portable blood analysis systems for use in any veterinary or human patient-care setting to provide clinicians with rapid blood constituent measurements.

Our principal offices are located at 3240 Whipple Road, Union City, California 94587 and our telephone number is (510) 675-6500. Our Internet address is www.abaxis.com. We make available free of charge on or through our Internet website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. Our common stock trades on the NASDAQ Global Market under the symbol ABAX.

Our primary product is a blood analysis system, consisting of a compact portable analyzer and a series of single-use plastic discs, called reagent discs, containing all the chemicals required to perform a panel of up to 13 tests on veterinary patients and 14 tests on human patients. The system can be operated with minimal training and performs multiple routine tests on whole blood, serum or plasma samples. The system provides test results in less than 14 minutes with the precision and accuracy equivalent to a clinical laboratory analyzer. We market the system in the human medical market under the name Piccolo® and in the veterinary market under the name VetScan VS2 .

In January 2006, we introduced the VetScan VS2, the next generation in-clinic veterinary diagnostic chemistry, electrolytes, immunoassay and blood gas instrument. The VetScan VS2 features a high-resolution, full color, touch screen and provides the flexibility to test multiple species. The design offers simple menu-driven choices to quickly and easily change instrument settings, select from five different languages, input customized species reference ranges, as well as perform a variety of other tasks. The VetScan VS2 also offers direct compatibility with a range of peripheral devices such as an external keyboard for data entry and printers for output. We manufacture the VetScan VS2 in our manufacturing facilities in Union City, California.

Through March 2006, we marketed the blood analysis system in the veterinary market as the VetScan®, now referred to as the VetScan Classic. We continue to support and service our current population of VetScan systems.

In May 2004, we introduced the VetScan HMII, a veterinary hematology instrument that offers an 18-parameter CBC (complete blood count) analysis, including a three-part white blood cell differential for the diagnostic assessment of patients by the veterinarian in their clinic. We currently purchase the hematology instruments from Diatron MI Kft. of Budapest.

Through April 2004, we marketed a veterinary hematology analyzer under the name VetScan HMT, which provided a complete blood count including a three-part white blood cell differential in less than 2 minutes and required only 12 µL (microliters) of whole blood. It provided results for eight selectable species, plus two user configurable programs. We marketed one type of reagent kit with this analyzer. We purchased the hematology analyzer and reagent kits from Melet Schloesing Laboratoires of France. We continue to support and service our current population of VetScan HMT hematology customers.

Critical Accounting Policies

Our financial statements were prepared in accordance with the accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and the sensitivity of these estimates to deviations in the assumptions used in making them. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. However, there can be no assurance that our actual results will not differ from these estimates.

We have identified the policies below as critical because they are not only important to understanding our financial condition and results of operations, but also because application and interpretation of these policies requires both judgment and estimates of matters that are inherently uncertain and unknown. As a result, actual results may differ materially from our estimates. The impact and any associated risks related to these policies on our business operations are discussed below. A more detailed discussion on the application of these and other accounting policies are included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2006.

Revenue Recognition and Deferred Revenue. Our primary customers are distributors and direct customers in both the veterinary and medical markets. Revenue from product sales, net of estimated sales allowances and rebates, is recognized when (i) evidence of an arrangement exists, (ii) upon shipment of the products to the customer, (iii) the sales price is fixed and determinable and (iv) collection of the resulting receivable is reasonably assured. Rights of return are not provided.

We recognize revenue associated with extended maintenance agreements ratably over the life of the contract. Amounts collected in advance of revenue recognition are recorded as a current or long-term liability based on the time from the balance sheet date to the future date of revenue recognition.

We provide incentives in the form of free goods or extended maintenance agreements to customers in connection with the sale of our instruments. Revenue from such sales is allocated separately to the instruments and free goods based on the relative fair value of each element. Revenue allocated to free goods is deferred until the goods are shipped to the customer, which is then recorded as an increase in revenue. The revenue associated with incentives related to extended maintenance agreements is recognized ratably over the maintenance period. We offer trade-in programs from time to time in which we will either provide incentives in the form of free goods to customers for purchasing our instruments or reduce the sales price of the instrument. These incentives in the form of free goods are recorded according to the policies described above.

Distributor and Customer Rebates. We offer distributor pricing rebates and customer incentive offerings from time to time. The distributor pricing rebates are offered to distributors upon meeting the sales volume requirements during the qualifying period. The distributor pricing rebates are recorded as a reduction to gross revenue during the qualifying period. Cash rebates are offered to customers who purchase specific instruments during the promotional period. The cash rebates are recorded as a reduction to gross revenue.

Sales and Other Allowances. We maintain sales allowances for defective reagent discs, which include the credit that we issue to customers for defective reagent discs. We also establish, upon shipment of our products to distributors, a provision for potentially defective reagent discs, based on historical experience. We estimate a provision for the potentially defective reagent discs shipped to distributors during the current period using internal data available to estimate the level of inventory in the distribution channel, the lag time for customers to report defective reagent discs and the historical experience of defective reagent discs. Changes in our estimates for accruals related to credits for defective reagent discs have not been material to operating income. Additional provisions and allowances may be required, resulting in decreased revenues, should we experience an increase of defective products. In the future, the actual defective reagent discs may exceed our estimates, which could adversely affect our operating income.

Allowance for Doubtful Accounts. We maintain an allowance for doubtful accounts based on our assessment of the collectibility of amounts owed to us by our customers. In determining the amount of the allowance, we make judgments about the creditworthiness of customers which is mostly determined by the customer s payment history and the outstanding period of accounts. We specifically identify amounts that we believe to be uncollectible and the allowance for doubtful accounts is adjusted accordingly. An additional allowance is recorded based on certain percentages of our aged receivables, using historical experience to estimate the potential uncollectible and our assessment of the general financial condition of our customer base. If our actual collections experience changes, revisions to our allowances may be required, which could adversely affect our operating income.

Warranty Reserves. We provide provisions at the time the related revenue is recognized for the estimated future costs to be incurred under our standard warranty obligation of two years on our instruments. While we engage in product quality programs and processes, including monitoring and evaluating the quality of our suppliers, our warranty obligation is affected by product failure rates, material usage and freight incurred in repairing the instrument after failure. We analyze the adequacy of the ending accrual balance each quarter. We maintain a reserve for the related warranty expenses based on historical experience of similar products. The determination of such allowance requires us to make estimates of the expected costs to repair or replace the instruments under warranty. If actual repair costs differ significantly from our estimates, adjustments to cost of revenues may be required.

Inventories. We state inventories at the lower of cost or market, cost being determined using standard costs which approximates the first-in, first-out (FIFO) method. Inventories include material, labor and overhead. We establish provisions for excess, obsolete and unusable inventories after evaluation of future demand and market conditions. If future demand or actual market conditions are less favorable than those estimated by management or if a significant amount of the material were to become unusable, additional inventory write-downs may be required, which would have a negative effect on our operating income.

Valuation of Long-Lived Assets. The carrying value of our long-lived assets is reviewed for impairment whenever events or changes in circumstances indicate that an asset may not be recoverable. We look to current and future profitability, as well as current and future undiscounted cash flows, excluding financing costs, as primary indicators of recoverability. An impairment loss would be recognized when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposal is less than the carrying amount. If impairment is determined to exist, any related impairment loss is calculated based on fair value.

Income Taxes. We account for income taxes under the provisions of Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amounts to be recovered.

Share-Based Compensation Expense. On April 1, 2006, we adopted SFAS No. 123(R) using the modified prospective method and therefore have not restated prior periods results. Under the fair value provisions of SFAS No. 123(R), we recognize share-based compensation expense, net of an estimated forfeiture rate, for those shares expected to vest over the requisite service period of the award to employees and directors. Prior to April 1, 2006, we accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25) and other related guidance and therefore, no employee compensation cost had been recognized for stock-based awards in financial statements prior to fiscal 2007 because we issued stock options with an exercise price equal to the market value at the date of grant.

We use the Black-Scholes option pricing model to determine the fair value of stock options granted prior to March 31, 2006 because the stock options granted were at an exercise price equal to the market value at the date of grant. Determining the appropriate fair value model and calculating the fair value of stock-based awards requires highly subjective assumptions, including estimating stock price volatility, expected life and forfeiture rates. As a result, if factors change and we use different assumptions, our share-based compensation expense could be materially different in the future. We estimate the volatility of our common stock at the date of grant based on the historical volatility of our common stock over a term of one year. We estimate the expected life of stock options granted based on historical exercise patterns, which we believe are representative of future behavior. We are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. The forfeiture rate is estimated based on historical data of our share-based awards that are granted, exercised and cancelled and upon historical experience of employee turnover. Changes in estimated forfeiture rates and differences between estimated forfeiture rates and actual experience may result in significant, unanticipated increases or decreases in share-based compensation expense from period to period. To the extent we revise our estimate of the forfeiture rate in the future, our share-based payment expense could be materially impacted in the quarter of revision, as well as in following quarters.

RESULTS OF OPERATIONS

Total Revenues

Abaxis currently operates in one segment, the development, manufacturing, marketing and sales of portable blood analysis systems for use in any veterinary or human patient-care setting to clinicians with rapid blood constituent measurement requirements. We summarize revenues by the following three categories: (i) geographic region based on customer location; (ii) product category; and (iii) customer group.

Revenues by Geographic Region and by Product Category - Revenues by geographic region based on customer location and revenues by product category during the three and six months ended September 30, 2006 and 2005 were as follows:

	Three Months Ended September 30,		Change		Six Months Ended September 30,		Change	
Revenues by Geographic Region	**2006**	**2005**	**Increase/ (Decrease)**	**% Change**	**2006**	**2005**	**Increase/ (Decrease)**	**% Change**
North America	$ 17,668,000	$ 14,951,000	$ 2,717,000	18%	$ 34,431,000	$ 27,038,000	$ 7,393,000	27%
Percentage of total revenues	84%	86%			83%	85%		
Europe	2,319,000	1,800,000	519,000	29%	4,762,000	3,484,000	1,278,000	37%
Percentage of total revenues	11%	10%			12%	11%		
Asia and Latin America	1,050,000	662,000	388,000	59%	2,202,000	1,164,000	1,038,000	89%
Percentage of total revenues	5%	4%			5%	4%		
Total revenues	$ 21,037,000	$ 17,413,000	$ 3,624,000	21%	$ 41,395,000	$ 31,686,000	$ 9,709,000	31%

	Three Months Ended September 30,		Change		Six Months Ended September 30,		Change	
Revenues by Product Category	**2006**	**2005**	**Increase/ (Decrease)**	**% Change**	**2006**	**2005**	**Increase/ (Decrease)**	**% Change**
Instruments	$ 6,568,000	$ 5,133,000	$ 1,435,000	28%	$ 13,298,000	$ 9,076,000	$ 4,222,000	47%
Percentage of total revenues	31%	29%			32%	29%		
Reagent discs and kits	12,280,000	10,606,000	1,674,000	16%	24,390,000	20,050,000	4,340,000	22%
Percentage of total revenues	59%	61%			59%	63%		
Other	1,688,000	1,071,000	617,000	58%	2,764,000	1,922,000	842,000	44%
Percentage of total revenues	8%	6%			7%	6%		
Product sales, net	20,536,000	16,810,000	3,726,000	22%	40,452,000	31,048,000	9,404,000	30%
Percentage of total revenues	98%	96%			98%	98%		
Development and licensing revenue	501,000	603,000	(102,000)	(17)%	943,000	638,000	305,000	48%
Percentage of total revenues	2%	4%			2%	2%		
Total revenues	$ 21,037,000	$ 17,413,000	$ 3,624,000	21%	$ 41,395,000	$ 31,686,000	$ 9,709,000	31%

Three Months Ended September 30, 2006 Compared with Three Months Ended September 30, 2005

North America. In the three months ended September 30, 2006, total revenues in North America increased 18%, or $2,717,000, as compared to the three months ended September 30, 2005. Components of the change in North America were as follows:

Instruments - In the three months ended September 30, 2006, total revenues from instruments sold in North America increased 32%, or $1,384,000, as compared to the three months ended September 30, 2005. The primary factors of the change were as follows:

(i) Sales of our Piccolo systems in North America (excluding the U.S. government) increased 44%, or $402,000, partially due to sales to two national distributors, offset by a change in the average selling price of Piccolo systems in North America (excluding the U.S. government). Sales of our Piccolo systems to the U.S. government decreased 40%, or $232,000, based primarily on the U.S. Military s needs for our products, which are not predictable.

(ii) Sales of our VetScan chemistry analyzers in North America increased 43%, or $613,000, due primarily to (a) an increase in sales personnel to promote our products and (b) an increase in the average selling price. Sales of our hematology systems in North America increased 42%, or $601,000, attributed primarily to a slower market acceptance of the hematology systems in the prior period.

Reagent discs and kits - In the three months ended September 30, 2006, total revenues from reagent discs and kits sold in North America increased 9%, or $834,000, as compared to the three months ended September 30, 2005. The primary factors of the change were as follows:

(i) Medical reagent discs sales in North America (excluding the U.S. government) increased 76%, or $589,000, due to the expanded installed base of our Piccolo systems. Medical reagent discs sold to the U.S. government decreased 20%, or $141,000, based primarily on the U.S. Military s needs for our products, which are not predictable.

(ii) Veterinary reagent discs sales in North America increased 2%, or $121,000, partially due to the expanded installed base of our VetScan chemistry analyzers, offset by a realignment of inventory in the distribution channel. Sales of hematology reagent kits in North America increased 54%, or $265,000, due to the expanded installed base of our hematology systems.

Other products - In the three months ended September 30, 2006, total revenues from other products sold in North America increased 57%, or $601,000, as compared to the three months ended September 30, 2005. The increase was due primarily to (a) an increase in demand from Becton, Dickinson and Company for products using the Orbos® Discrete Lyophilization Process, which is based on seasonal demands, and (b) an increase in billable repairs.

Development and licensing -In the three months ended September 30, 2006, total revenues from development and licensing in North America decreased 17%, or $102,000, as compared to the three months ended September 30, 2005. The development and licensing revenue is based on our licensed agreements of our technology underlying the Orbos process to GE Healthcare (formerly Amersham Bioscience Corp.) and Cepheid.

Significant concentration - One distributor in the United States, DVM Resources, accounted for 16% of total worldwide revenues for the three months ended September 30, 2006. Two distributors in the United States, Henry Schein, Inc. and DVM Resources, accounted for 16% and 14%, respectively, of total worldwide revenues for the three months ended September 30, 2005.

Europe. In the three months ended September 30, 2006, total revenues in Europe increased 29%, or $519,000, as compared to the three months ended September 30, 2005. Components of the change in Europe were as follows:

Instruments - In the three months ended September 30, 2006, total revenues from instruments sold in Europe decreased 31%, or $175,000, as compared to the three months ended September 30, 2005. The primary factors of the change were as follows:

(i) Sales of our Piccolo systems in Europe decreased 50%, or $78,000.

(ii) Sales of our VetScan chemistry analyzers in Europe decreased 41%, or $142,000, due primarily to manufacturing issues related to start-up expenses associated with the introduction of the new VetScan VS2 product line. Sales of our hematology systems in Europe increased 83%, or $45,000.

Reagent discs and kits - In the three months ended September 30, 2006, total revenues from reagent discs and kits sold in Europe increased 55%, or $686,000, as compared to the three months ended September 30, 2005. The primary factors of the change were as follows:

(i) Medical reagent discs sales in Europe increased 166%, or $138,000, due to the expanded installed base of our Piccolo systems.

(ii) Veterinary reagent discs sales in Europe increased 48%, or $533,000, due to the expanded installed base of our VetScan chemistry analyzers. Sales of hematology reagent kits in Europe increased 42%, or $15,000.

Other products- In the three months ended September 30, 2006, total revenues from other products sold in Europe increased 160%, or $8,000, as compared to the three months ended September 30, 2005.

Asia and Latin America. In the three months ended September 30, 2006, total revenues in Asia and Latin America increased 59%, or $388,000, as compared to the three months ended September 30, 2005. Components of the change in Asia and Latin America were as follows:

Instruments - In the three months ended September 30, 2006, total revenues from instruments sold in Asia and Latin America increased 106%, or $226,000, as compared to the three months ended September 30, 2005. The primary factors of the change were as follows:

(i) Sales of our Piccolo systems in Asia and Latin America were the same as the prior period.

(ii) Sales of our VetScan chemistry analyzers increased 132%, or $198,000, and sales of our hematology systems increased 47%, or $28,000, in Asia and Latin America. The increase in VetScan chemistry analyzers and hematology systems was due primarily to our distribution partner in Japan. In the second quarter of fiscal 2006, our distributor in Japan received clearance from the Japanese regulatory agency to import and market the Piccolo and VetScan systems.

Reagent discs and kits - In the three months ended September 30, 2006, total revenues from reagent discs and kits sold in Asia and Latin America increased 35%, or $154,000, as compared to the three months ended September 30, 2005. The primary factors of the change were as follows:

(i) Medical reagent discs sales in Asia and Latin America increased 32%, or $8,000.

(ii) Veterinary reagent discs sales in Asia and Latin America increased 30%, or $119,000, due to the expanded installed base of our VetScan chemistry analyzers. Sales of hematology reagent kits in Asia and Latin America increased 129%, or $27,000.

Other products - In the three months ended September 30, 2006, total revenues from other products sold in Asia and Latin America increased 200%, or $8,000, as compared to the three months ended September 30, 2005.

Six Months Ended September 30, 2006 Compared with Six Months Ended September 30, 2005

North America. In the six months ended September 30, 2006, total revenues in North America increased 27%, or $7,393,000, as compared to the six months ended September 30, 2005. Components of the change in North America were as follows:

Instruments - In the six months ended September 30, 2006, total revenues from instruments sold in North America increased 42%, or $3,176,000, as compared to the six months ended September 30, 2005. The primary factors of the change were as follows:

(i) Sales of our Piccolo systems in North America (excluding the U.S. government) increased 91%, or $1,204,000, partially due to sales to two national distributors, offset by a change in the average selling price of Piccolo systems in North America (excluding the U.S. government). Sales of our Piccolo systems to the U.S. government decreased 27%, or $197,000, based primarily on the U.S. Military s needs for our products, which are not predictable.

(ii) Sales of our VetScan chemistry analyzers in North America increased 43%, or $1,260,000, due primarily to (a) an increase in sales personnel to promote our products and (b) an increase in the average selling price. Sales of our hematology systems in North America increased 36%, or $909,000, attributed primarily to a slower market acceptance of the hematology systems in the prior period.

Reagent discs and kits - In the six months ended September 30, 2006, total revenues from reagent discs and kits sold in North America increased 18%, or $3,089,000, as compared to the six months ended September 30, 2005. The primary factors of the change were as follows:

(i) Medical reagent discs sales in North America (excluding the U.S. government) increased 96%, or $1,318,000, due to the expanded installed base of our Piccolo systems. Medical reagent discs sold to the U.S. government increased 16%, or $155,000, due to an increase in the U.S. Military s needs for our products during the first quarter of fiscal 2007.

(ii) Veterinary reagent discs sales in North America increased 9%, or $1,217,000, partially due to the expanded installed base of our VetScan chemistry analyzers, offset by a realignment of inventory in the distribution channel. Sales of hematology reagent kits in North America increased 35%, or $399,000, due to the expanded installed base of our hematology systems.

Other products - In the six months ended September 30, 2006, total revenues from other products sold in North America increased 43%, or $823,000, as compared to the six months ended September 30, 2005. The increase was due primarily to (a) an increase in demand from Becton, Dickinson and Company for products using the Orbos Discrete Lyophilization Process, which is based on seasonal demands, and (b) an increase in billable repairs.

Development and licensing - In the six months ended September 30, 2006, total revenues from development and licensing in North America increased 48%, or $305,000, as compared to the six months ended September 30, 2005. The development and licensing revenue is based on our licensed agreements of our technology underlying the Orbos process to GE Healthcare (formerly Amersham Bioscience Corp.) and Cepheid.

Significant concentration - One distributor in the United States, DVM Resources, accounted for 16% of total worldwide revenues for the six months ended September 30, 2006. Two distributors in the United States, DVM Resources and Henry Schein, Inc., accounted for 16% and 15%, respectively, of total worldwide revenues for the six months ended September 30, 2005.

We had a distribution partnership with the veterinary division of Henry Schein, Inc. from April 2004 through May 2006. In May 2006, both Abaxis and Henry Schein determined that it was in the best interest of both companies to discontinue the distribution agreement due to Henry Schein s acquisition of a regional distributor of a competing company in the veterinary market. To support those customers who were previously supplied products by Henry Schein, our plan is to have our current distributors supply and service these sites, or depending on the customer s needs and geographical location, we will support and service these customers on a direct basis as well.

Europe. In the six months ended September 30, 2006, total revenues in Europe increased 37%, or $1,278,000, as compared to the six months ended September 30, 2005. Components of the change in Europe were as follows:

Instruments - In the six months ended September 30, 2006, total revenues from instruments sold in Europe increased 24%, or $290,000, as compared to the six months ended September 30, 2005. The primary factors of the change were as follows:

(i) Sales of our Piccolo systems in Europe increased 13%, or $24,000.

(ii) Sales of our VetScan chemistry analyzers in Europe increased 20%, or $177,000. The increase was offset by a decrease in sales in the second quarter of fiscal 2007 due to manufacturing issues related to start-up expenses associated with the introduction of the new VetScan VS2 product line. Sales of our hematology systems in Europe increased 72%, or $89,000.

Reagent discs and kits - In the six months ended September 30, 2006, total revenues from reagent discs and kits sold in Europe increased 43%, or $975,000, as compared to the six months ended September 30, 2005. The primary factors of the change were as follows:

(i) Medical reagent discs sales in Europe increased 134%, or $206,000, due to the expanded installed base of our Piccolo systems.

(ii) Veterinary reagent discs sales in Europe increased 36%, or $735,000, due to the expanded installed base of our VetScan chemistry analyzers. Sales of hematology reagent kits in Europe increased 48%, or $34,000.

Other products - In the six months ended September 30, 2006, total revenues from other products sold in Europe increased 108%, or $13,000, as compared to the six months ended September 30, 2005.

Asia and Latin America. In the six months ended September 30, 2006, total revenues in Asia and Latin America increased 89%, or $1,038,000, as compared to the six months ended September 30, 2005. Components of the change in Asia and Latin America were as follows:

Instruments - In the six months ended September 30, 2006, total revenues from instruments sold in Asia and Latin America increased 190%, or $756,000, as compared to the six months ended September 30, 2005. The primary factors of the change were as follows:

(i) Sales of our Piccolo systems in Asia and Latin America decreased 92%, or $56,000.

(ii) Sales of our VetScan chemistry analyzers increased 188%, or $442,000, and sales of our hematology systems increased 363%, or $370,000, in Asia and Latin America. The increase in VetScan chemistry analyzers and hematology systems was due primarily to our distribution partner in Japan. In the second quarter of fiscal 2006, our distributor in Japan received clearance from the Japanese regulatory agency to import and market the Piccolo and VetScan systems.

Reagent discs and kits - In the six months ended September 30, 2006, total revenues from reagent discs and kits sold in Asia and Latin America increased 36%, or $276,000, as compared to the six months ended September 30, 2005. The primary factors of the change were as follows:

(i) Medical reagent discs sales in Asia and Latin America decreased 13%, or $7,000.

(ii) Veterinary reagent discs sales in Asia and Latin America increased 35%, or $229,000, due to the expanded installed base of our VetScan chemistry analyzers. Sales of hematology reagent kits in Asia and Latin America increased 123%, or $54,000.

Other products - In the six months ended September 30, 2006, total revenues from other products sold in Asia and Latin America increased 86%, or $6,000, as compared to the six months ended September 30, 2005.

Revenues by Customer Group - Revenues by customer group during the three and six months ended September 30, 2006 and 2005 were as follows:

	Three Months Ended September 30,		Change		Six Months Ended September 30,		Change	
Revenues by Customer Group	**2006**	**2005**	**Increase/ (Decrease)**	**% Change**	**2006**	**2005**	**Increase/ (Decrease)**	**% Change**
Medical Market	$ 4,120,000	$ 3,347,000	$ 773,000	23%	$ 7,850,000	$ 5,021,000	$ 2,829,000	56%
Percentage of total revenues	20%	19%			19%	16%		
Veterinary Market	15,160,000	12,713,000	2,447,000	19%	30,701,000	24,719,000	5,982,000	24%
Percentage of total revenues	72%	73%			74%	78%		
Other	1,757,000	1,353,000	404,000	30%	2,844,000	1,946,000	898,000	46%
Percentage of total revenues	8%	8%			7%	6%		
Total revenues	$ 21,037,000	$ 17,413,000	$ 3,624,000	21%	$ 41,395,000	$ 31,686,000	$ 9,709,000	31%

Three Months Ended September 30, 2006 Compared with Three Months Ended September 30, 2005

Medical Market. In the three months ended September 30, 2006, total revenues in the medical market increased 23%, or $773,000, as compared to the three months ended September 30, 2005. Components of the change were as follows:

Instruments - Total revenues from Piccolo systems increased 6%, or $92,000, in the three months ended September 30, 2006, as compared to the three months ended September 30, 2005. We sold a total of 173 Piccolo systems in the three months ended September 30, 2006, as compared to 139 Piccolo systems sold in the three months ended September 30, 2005. The change in revenue was attributed to (a) an increase in North America (excluding the U.S. government) of 44%, or $402,000, due to sales to two national distributors, offset by (b) a change in the average selling price of Piccolo systems in North America (excluding the U.S. government), (c) a decrease in Piccolo systems sold to the U.S. government of 40%, or $232,000, based primarily on the U.S. Military s needs for our products, which are not predictable, and (d) a decrease in Europe of 50%, or $78,000.

Reagent discs and kits - Total revenues from reagent discs sold in the medical market increased 37%, or $594,000, in the three months ended September 30, 2006, as compared to the three months ended September 30, 2005. We sold 237,000 reagent discs in the three months ended September 30, 2006, as compared to 159,000 reagent discs sold in the three months ended September 30, 2005. The change was attributed to (a) an increase in North America (excluding the U.S. government) of 76%, or $589,000, due to the expanded installed base of our Piccolo systems, (b) an increase in Europe of 166%, or $138,000, due to the expanded installed base of our Piccolo systems and (c) an increase in Asia and Latin America of 32%, or $8,000, offset by (d) a decrease in reagent discs sold to the U.S. government of 20%, or $141,000, based primarily on the U.S. Military s needs for our products, which are not predictable.

Veterinary Market. In the three months ended September 30, 2006, total revenues in the veterinary market increased 19%, or $2,447,000, as compared to the three months ended September 30, 2005. Components of the change were as follows:

Instruments - We sold a total of 543 VetScan chemistry analyzers and hematology systems in the three months ended September 30, 2006, as compared to 428 veterinary instruments sold in the three months ended September 30, 2005.

(i) Sales of our VetScan chemistry analyzers increased 35%, or $669,000, comprising an increase in North America of 43%, or $613,000, and an increase in Asia and Latin America of 132%, or $198,000, offset by a decrease in Europe of 41%, or $142,000. The increase in VetScan chemistry analyzers was attributed primarily to sales in North America due to (a) an increase in sales personnel to promote our products and (b) an increase in the average selling price.

(ii) Sales of our hematology systems increased 43%, or $674,000, comprising an increase in North America of 42%, or $601,000, an increase in Europe of 83%, or $45,000, and an increase in Asia and Latin America of 47%, or $28,000. The increase was attributed primarily to a slower market acceptance of the hematology systems in the prior period.

Reagent discs and kits - Total revenues from reagent discs and kits sold in the veterinary market increased 12%, or $1,080,000, in the three months ended September 30, 2006, as compared to the three months ended September 30, 2005.

(i) We sold 770,000 reagent discs in the three months ended September 30, 2006, as compared to 712,000 reagent discs sold in the three months ended September 30, 2005. The increase in revenue from reagent discs was attributed to (a) an increase in North America of 2%, or $121,000, partially due to the expanded installed base of our VetScan chemistry analyzers, offset by a realignment of inventory in the distribution channel, (b) an increase in Europe of 48%, or $533,000, due to the expanded installed base of our VetScan chemistry analyzers and (c) an increase in Asia and Latin America of 30%, or $119,000, due to the expanded installed base of our VetScan chemistry analyzers.

(ii) We sold 4,000 hematology reagent kits in the three months ended September 30, 2006, as compared to 3,000 hematology reagent kits in the three months ended September 30, 2005. The unit increase of hematology reagent kits was due to the expanded installed base of our hematology systems.

Other. In the three months ended September 30, 2006, total revenues from other customer groups increased 30%, or $404,000, as compared to the three months ended September 30, 2005. The increase was due primarily to (a) an increase in demand from Becton, Dickinson and Company for products using the Orbos Discrete Lyophilization Process, which is based on seasonal demands, and (b) an increase in billable repairs.

Six Months Ended September 30, 2006 Compared with Six Months Ended September 30, 2005

Medical Market. In the six months ended September 30, 2006, total revenues in the medical market increased 56%, or $2,829,000, as compared to the six months ended September 30, 2005. Components of the change were as follows:

Instruments - Total revenues from Piccolo systems increased 42%, or $975,000, in the six months ended September 30, 2006, as compared to the six months ended September 30, 2005. We sold a total of 297 Piccolo systems in the six months ended September 30, 2006, as compared to 195 Piccolo systems sold in the six months ended September 30, 2005. The change in revenue was attributed to (a) an increase in North America (excluding the U.S. government) of 91%, or $1,204,000, due to sales to two national distributors and (b) an increase in Europe of 13%, or $24,000, offset by (c) a change in the average selling price of Piccolo systems in North America (excluding the U.S. government), (d) a decrease in Piccolo systems sold to the U.S. government of 27%, or $197,000, based primarily on the U.S. Military s needs for our products, which are not predictable, and (e) a decrease in Asia and Latin America of 92%, or $56,000.

Reagent discs and kits - Total revenues from reagent discs sold in the medical market increased 66%, or $1,672,000, in the six months ended September 30, 2006, as compared to the six months ended September 30, 2005. We sold 457,000 reagent discs in the six months ended September 30, 2006, as compared to 252,000 reagent discs sold in the six months ended September 30, 2005. The change was attributed to (a) an increase in North America (excluding the U.S. government) of 96%, or $1,318,000, due to the expanded installed base of our Piccolo systems, (b) an increase in reagent discs sold to the U.S. government of 16%, or $155,000, due to an increase in the U.S. Military s needs for our products during the first quarter of fiscal 2007 and (c) an increase in Europe of 134%, or $206,000, due to the expanded installed base of our Piccolo systems, offset by (d) a decrease in Asia and Latin America of 13%, or $7,000.

Veterinary Market. In the six months ended September 30, 2006, total revenues in the veterinary market increased 24%, or $5,982,000, as compared to the six months ended September 30, 2005. Components of the change were as follows:

Instruments - We sold a total of 1,148 VetScan chemistry analyzers and hematology systems in the six months ended September 30, 2006, as compared to 863 veterinary instruments sold in the six months ended September 30, 2005.

(i) Sales of our VetScan chemistry analyzers increased 47%, or $1,879,000, comprising an increase in North America of 43%, or $1,260,000, an increase in Europe of 20%, or $177,000, and an increase in Asia and Latin America of 188%, or $442,000. The increase in VetScan chemistry analyzers was attributed primarily to the worldwide release of the VetScan VS2 system in the first quarter of fiscal 2007.

(ii) Sales of our hematology systems increased 50%, or $1,368,000, comprising an increase in North America of 36%, or $909,000, an increase in Europe of 72%, or $89,000, and an increase in Asia and Latin America of 363%, or $370,000. The increase was attributed primarily to a slower market acceptance of the hematology systems in the prior period.

Reagent discs and kits - Total revenues from reagent discs and kits sold in the veterinary market increased 15%, or $2,668,000, in the six months ended September 30, 2006, as compared to the six months ended September 30, 2005.

(i) We sold 1,507,000 reagent discs in the six months ended September 30, 2006, as compared to 1,386,000 reagent discs sold in the six months ended September 30, 2005. The increase in revenue from reagent discs was attributed to (a) an increase in North America of 9%, or $1,217,000, partially due to the expanded installed base of our VetScan chemistry analyzers, offset by a realignment of inventory in the distribution channel, (b) an increase in Europe of 36%, or $735,000, due to the expanded installed base of our VetScan chemistry analyzers and (c) an increase in Asia and Latin America of 35%, or $229,000, due to the expanded installed base of our VetScan chemistry analyzers.

(ii) We sold 8,000 hematology reagent kits in the six months ended September 30, 2006, as compared to 6,000 hematology reagent kits in the six months ended September 30, 2005. The unit increase of hematology reagent kits was due to the expanded installed base of our hematology systems.

Other. In the six months ended September 30, 2006, total revenues from other customer groups increased 46%, or $898,000, as compared to the six months ended September 30, 2005. The increase was due primarily to (a) an increase in demand from Becton, Dickinson and Company for products using the Orbos Discrete Lyophilization Process, which is based on seasonal demands, and (b) an increase in development and licensing revenue, which is based on our licensed agreements of our technology underlying the Orbos process to GE Healthcare (formerly Amersham Bioscience Corp.) and Cepheid.

Cost of Revenues

The following sets forth, for the periods indicated, our cost of revenues:

	Three Months Ended September 30,		Change		Six Months Ended September 30,		Change	
	2006	2005	Increase/ (Decrease)	% Change	2006	2005	Increase/ (Decrease)	% Change
Cost of revenues	$ 9,479,000	$ 7,321,000	$ 2,158,000	29%	$ 18,400,000	$ 13,767,000	$ 4,633,000	34%
Percentage of total revenues	45%	42%			44%	43%		

Cost of revenues includes the costs associated with manufacturing, assembly, packaging, warranty repairs, test and quality assurance for our instruments, reagent discs and hematology reagents and manufacturing overhead, including costs of personnel and equipment associated with manufacturing support.

Three and Six Months Ended September 30, 2006 Compared with Three and Six Months Ended September 30, 2005

The increase in cost of revenues in absolute dollars in the three and six months ended September 30, 2006, as compared to the three and six months ended September 30, 2005, was due primarily to (a) an increase in the sales volume of instruments and reagent discs and kits and (b) an increase in costs associated with manufacturing the VetScan VS2 system. As a percentage of total revenues, cost of revenues increased in the three months ended September 30, 2006, as compared to the three months ended September 30, 2005, due to (a) costs associated with manufacturing the VetScan VS2 system and (b) a change in the average selling price of Piccolo systems.

Operating Expenses

Research and Development

The following sets forth, for the periods indicated, our research and development expenses:

	Three Months Ended September 30,		Change		Six Months Ended September 30,		Change	
	2006	2005	Increase/ (Decrease)	% Change	2006	2005	Increase/ (Decrease)	% Change
Research and development expenses	$ 1,519,000	$ 1,431,000	$ 88,000	6%	$ 3,236,000	$ 3,063,000	$ 173,000	6%
Percentage of total revenues	7%	8%			8%	10%		

Research and development expenses consist of salaries and benefits, related expenses associated with the development of new tests and test methods, product improvements and enhancement of existing products and clinical trials.

Three and Six Months Ended September 30, 2006 Compared with Three and Six Months Ended September 30, 2005

The increase in research and development expenses in the three and six months ended September 30, 2006, as compared to the three and six months ended September 30, 2005, related to new product development in both the medical and veterinary markets. The higher investments in research and development were attributed primarily to the ongoing work on the in-clinic human diagnostic chemistry analyzer, the Piccolo-Xpress. Other projects included clinical trials, developing new immunoassay tests and preparation of submission for CLIA waived status on new test methods. Share-based compensation expense incurred in connection with our adoption of SFAS No.123(R) for the three and six months ended September 30, 2006 was $31,000 and $58,000, respectively.

We anticipate the dollar amount of research and development expenses to increase in fiscal 2007 from fiscal 2006 but remain consistent as a percentage of total revenues, as we complete new products for both the medical and veterinary markets. There can be no assurance, however, that we will undertake such research and development activities in future periods or, if we do, that such activities will be successful.

Sales and Marketing

The following sets forth, for the periods indicated, our sales and marketing expenses:

	Three Months Ended September 30,		Change		Six Months Ended September 30,		Change	
	2006	2005	Increase/ (Decrease)	% Change	2006	2005	Increase/ (Decrease)	% Change
Sales and marketing expenses	$ 5,533,000	$ 3,814,000	$ 1,719,000	45%	$ 10,004,000	$ 7,035,000	$ 2,969,000	42%
Percentage of total revenues	26%	22%			24%	22%		

Sales and marketing expenses consist of personnel costs, including salaries and benefits, commissions and travel related expenses for personnel engaged in selling, costs associated with advertising, lead generation, marketing programs, trade shows, and services related to customer and technical support.

Three and Six Months Ended September 30, 2006 Compared with Three and Six Months Ended September 30, 2005

The increase in sales and marketing expenses during the three and six months ended September 30, 2006, as compared to the three and six months ended September 30, 2005, was related primarily to personnel-related costs resulting from an increase in headcount in various divisions such as sales and marketing, customer service and technical service, to support the growth in both our medical and veterinary markets. Share-based compensation expense incurred in connection with our adoption of SFAS No. 123(R) for the three and six months ended September 30, 2006 was $76,000 and $153,000, respectively.

General and Administrative

The following sets forth, for the periods indicated, our general and administrative expenses:

	Three Months Ended September 30,		Change		Six Months Ended September 30,		Change	
	2006	2005	Increase/ (Decrease)	% Change	2006	2005	Increase/ (Decrease)	% Change
General and administrative expenses	$ 1,386,000	$ 1,378,000	$ 8,000	1%	$ 2,970,000	$ 2,832,000	$ 138,000	5%
Percentage of total revenues	7%	8%			7%	9%		

General and administrative expenses consist of personnel costs and expenses for outside professional services related to general corporate functions, including accounting, human resources and legal.

Three and Six Months Ended September 30, 2006 Compared with Three and Six Months Ended September 30, 2005

The increase in general and administrative expenses during the three and six months ended September 30, 2006, as compared to the three and six months ended September 30, 2005, was related primarily to an increase in share-based compensation expense incurred in connection with our adoption of SFAS No. 123(R) in fiscal 2007, offset by a decrease in professional services incurred in fiscal 2007. The share-based compensation expense for the three and six months ended September 30, 2006 was $84,000 and $150,000, respectively.

Interest and Other Income (Expense), Net

The following sets forth our interest and other income (expense), net:

	Three Months Ended September 30,		% Change	Six Months Ended September 30,		% Change
	2006	2005		2006	2005	
Interest and other income	$ 394,000	$ 181,000		$ 734,000	$ 247,000	
Interest and other expense	(27,000)			(31,000)	(13,000)	
Interest and other income (expense), net	$ 367,000	$ 181,000	103%	$ 703,000	$ 234,000	200%

Interest and other income (expense), net, consists primarily of interest earned on cash, cash equivalents and short-term investments and realized gains on short-term investments.

Three and Six Months Ended September 30, 2006 Compared with Three and Six Months Ended September 30, 2005

The increase in interest and other income (expense), net, in the three and six months ended September 30, 2006, as compared to the three and six months ended September 30, 2005, was due primarily to higher average invested balances and realized gains on short-term investments in the fiscal 2007 periods.

Income Tax Provision

The following sets forth, for the periods indicated, our income tax provision:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2006	2005	2006	2005

Income tax provision	$ 1,373,000	$ 1,352,000	$ 2,973,000	$ 1,924,000
Effective tax rate	39%	37%	40%	37%

Three and Six Months Ended September 30, 2006 Compared with Three and Six Months Ended September 30, 2005

The increase in the effective tax rate for the three and six months ended September 30, 2006, as compared to the three and six months ended September 30, 2005, was due to non-deductible share-based compensation expense and the expiration of the federal research and development tax credit.

LIQUIDITY AND CAPITAL RESOURCES

Total cash, cash equivalents and short-term investments were as follows:

	September 30, 2006	March 31, 2006
Cash and cash equivalents	$ 13,227,000	$ 10,164,000
Short-term investments	26,870,000	20,372,000
Total cash, cash equivalents and short-term investments	$ 40,097,000	$ 30,536,000
Percentage of total assets	43%	37%

Cash provided (used) in the six months ended September 30, 2006 and 2005 were as follows:

	Six Months Ended September 30,	
	2006	2005
Cash provided by operating activities	$ 9,025,000	$ 5,686,000
Cash used in investing activities	(8,908,000)	(1,638,000)
Cash provided by financing activities	2,946,000	265,000
Net increase in cash and cash equivalents	$ 3,063,000	$ 4,313,000

Operating Activities

During the six months ended September 30, 2006, we generated $9,025,000 in cash from operating activities compared to $5,686,000 during the six months ended September 30, 2005. The change during the six months period ended September 30, 2006 was the result of net income of $4,515,000, adjusted for the effects of non-cash expenses including depreciation and amortization of $1,253,000, share-based compensation expense of $387,000 and a decrease in non-current net deferred tax asset of $2,730,000.

Our net trade receivables increased by $162,000, from $14,638,000 at March 31, 2006 to $14,800,000 as of September 30, 2006, primarily due to higher sales in the last month of the quarter ended September 30, 2006. Inventories increased by $1,059,000, from $10,396,000 at March 31, 2006 to $11,455,000 as of September 30, 2006, primarily related to new product introduction. Prepaid expenses increased by $234,000, from $446,000 at March 31, 2006 to $680,000 as of September 30, 2006, primarily due to an increase in the prepayments of marketing related expenses.

Non-current net deferred tax asset decreased by $2,730,000, from $12,125,000 at March 31, 2006 to $9,395,000 as of September 30, 2006, as a result of the utilization of federal net operating loss carryforwards and California research and development tax credit carryforwards during the six months ended September 30, 2006.

Accounts payable increased by $1,450,000, from $4,614,000 at March 31, 2006 to $6,064,000 as of September 30, 2006, primarily due to the timing and payment of services and inventory purchases. Accrued payroll and related expenses decreased by $246,000, from $3,890,000 at March 31, 2006 to $3,644,000 as of September 30, 2006, primarily due to the timing of the payout of our management incentive compensation program. Other accrued liabilities increased by $284,000, from $705,000 at March 31, 2006 to $989,000 as of September 30, 2006, primarily due to the timing of payment of services and marketing programs. The current portion of warranty reserves increased by $100,000, from $213,000 at March 31, 2006 to $313,000 as of September 30, 2006, primarily due to an increase in the installed base of our instruments. The current portion of deferred revenue decreased by $93,000, from $939,000 as of March 31, 2006 to $846,000 as of September 30, 2006, primarily due to the reduction of incentives in the form of free goods given to customers.

We anticipate that we will incur incremental additional costs to support our future operations, including further additional pre-clinical testing and clinical trials for our current and future products; research and design costs related to the continuing development of our current and future products; and acquisition of capital equipment for our manufacturing facility, which includes the ongoing costs related to the continuing development of our current and future products.

We anticipate that our existing capital resources, available line of credit and anticipated revenue from the sales of our products will be adequate to satisfy our currently planned operating and financial requirements through at least the next twelve months. Our future capital requirements will largely depend upon the increased market acceptance of our point-of-care blood analyzer products. However, our sales for any future periods are not predictable with a significant degree of certainty. Regardless, we may seek to raise additional funds to pursue strategic opportunities.

Investing Activities

Net cash used in investing activities during the six months ended September 30, 2006 was $8,908,000. Cash used to purchase short-term investments, consisting of corporate obligations, totaled $39,177,000. Cash provided by the proceeds from the maturities of various short-term investments totaled $32,779,000.

Cash used in investing activities also included purchases of property and equipment of $2,510,000, primarily to support (a) increased product demand, (b) new product introduction and (c) our goal of more efficient production lines. We anticipate that we will continue to purchase property and equipment necessary in the normal course of our business.

Financing Activities

Net cash provided by financing activities during the six months ended September 30, 2006 was $2,946,000, which consisted of net cash proceeds from the exercise of stock options and warrants.

Line of Credit

We have a line of credit with Comerica Bank-California which provides for borrowings of up to $2,000,000. The line of credit terminates upon notification by either party and the outstanding balance is payable upon demand. The line of credit bears interest at the bank s prime rate minus 0.25%, which totaled 8.00% at September 30, 2006, and is payable monthly. Of the $2,000,000 available, $410,000 was committed to secure a letter of credit for our facilities lease at September 30, 2006. At September 30, 2006, there was no amount outstanding under our line of credit. The weighted average interest rates on the line of credit during the three months ended September 30, 2006 and 2005 were 8.00% and 6.17%, respectively.

The line of credit agreement contains certain financial covenants, which are evaluated on a quarterly basis. Included in these financial covenants, among other stipulations, is a requirement that we have a minimum net income of $25,000 before preferred stock dividends and accretion in any three quarters of a fiscal year, provided that any loss before preferred stock dividends and accretion on preferred stock incurred in the remaining quarter is not to exceed $250,000. We are also required to be profitable, as defined, on a fiscal year to date basis beginning with the six months period ending September 30, 2006 and to have net income before preferred stock dividends and accretion on preferred stock of $1,150,000 for the fiscal year ending March 31, 2007. In addition, we are required to have a quick ratio, as defined, of not less than 2.00 to 1.00, cash flow coverage, as defined, of not less than 1.25 to 1.00, debt to net worth ratio, as defined, not greater than 1.00 to 1.00 and to maintain a tangible effective net worth, as defined, of not less than $25,731,000. At September 30, 2006, we were in compliance with these covenants.

Borrowings under the line of credit are collateralized by our net book value of assets of $79.0 million at September 30, 2006, including our intellectual property.

Purchase Commitments

A discussion of our recently amended original equipment manufacturing agreement with Diatron Messtechnik GmbH is included in Note 5 of the Notes to the Condensed Financial Statements.

Contingencies

We are involved from time to time in various litigation matters in the normal course of business. We believe that the ultimate resolution of these matters will not have a material effect on our financial position or results of operations.

RECENT ACCOUNTING PRONOUNCEMENTS

A discussion of recent accounting pronouncements is included in Note 1 of the Notes to the Condensed Financial Statements.

RISK FACTORS THAT MAY AFFECT OUR PERFORMANCE

Our future performance is subject to a number of risks. If any of the following risks actually occur, our business could be harmed and the trading price of our common stock could decline.

When used in these risk factors, the words anticipates, believes, expects, intends, plans, future, and similar expressions identify forward-l statements. Our actual results could differ materially from those that we project in the forward-looking statements as a result of factors that we have set forth throughout this document as well as factors of which we are currently not aware.

We have only recently become consistently profitable and we must increase sales of our Piccolo and VetScan products or we may not be able to maintain profitability.

We have not recognized a net loss attributable to common shareholders in the last twelve fiscal quarters ended September 30, 2006. However, as of September 30, 2006, we have cumulative net losses of $21.0 million. Our ability to be consistently profitable will depend, in part, on our ability to increase our sales volumes of our Piccolo and VetScan products. Increasing the sales volume of our products will depend upon our ability to:

continue to develop our products;

increase our sales and marketing activities;

effectively manage our manufacturing activities; and

effectively compete against current and future competitors.

We cannot assure you that we will be able to successfully increase our sales volumes of our products to achieve sustained profitability.

We are not able to predict sales in future quarters and a number of factors affect our periodic results, which makes our quarterly operating results less predictable.

We are not able to accurately predict our sales in future quarters. Our revenue in the veterinary market are derived primarily by selling to distributors who resell our products to the ultimate user. While we are better able to predict sales of our reagent discs, as we sell these discs primarily for use with blood chemistry analyzers that we sold in prior periods, we generally are unable to predict with much certainty sales of our blood chemistry analyzers, as we typically sell our blood chemistry analyzers to new users. Accordingly, our sales in any one quarter are not indicative of our sales in any future period.

We generally operate with limited order backlog, because we ship our products shortly after we receive the orders from our customers. As a result, our product sales in any quarter are generally dependent on orders that we receive and ship in that quarter. We base our expense levels, which are to a large extent fixed, in part on our expectations as to future revenues. We may be unable to reduce our spending in a timely manner to compensate for any unexpected revenue shortfall. As a result, any such shortfall would immediately materially and adversely impact our operating results and financial condition.

Historically, we have experienced a decrease in our sales, especially in Europe, in our second and third quarters ending in September and December of each year, which we believe is due to seasonal patterns in the decision making processes to acquire our products. Accordingly, we believe that period to period comparisons of our results of operations are not necessarily meaningful.

Our periodic operating results have varied in the past. In the future, we anticipate our periodic operating results to vary significantly depending on, but not limited to, a number of factors, including, in addition to those factors discussed elsewhere in this section:

new product announcements made by us or our competitors;

changes in our pricing structures or the pricing structures of our competitors;

our ability to develop, introduce and market new products on a timely basis;

our manufacturing capacities and our ability to increase the scale of these capacities;

the mix of product sales between our blood chemistry analyzer and our reagent disc products;

the amount we spend on research and development; and

changes in our strategy.

We could fail to achieve anticipated revenue if the market does not accept our products.

Our core compact blood chemistry analyzer product differs substantially from current blood chemistry analyzers on the market. Our primary competition is from centralized laboratories that offer a greater number of tests than our products, but do so at a greater cost and require more time. We also compete with other point-of-care analyzers that cost more, require more maintenance and offer a narrower range of tests. However, these point-of-care analyzers are generally marketed by larger companies which have greater resources for sales and marketing, in addition to a recognized brand name and established distribution relationships.

27

Historically we have marketed our VetScan systems through both direct sales and distribution channels to veterinarians. Although we believe that in our targeted markets, our reagent disc products provide a sufficient breadth of test menus, we continue to develop new animal blood tests and we cannot be assured that the tests will be accepted by the veterinary market.

In the human medical market, we have relatively limited experience in large scale sales of our Piccolo blood chemistry analyzer. Although we believe that our blood chemistry analyzers offer consumers many advantages, including according to our analyses substantial cost savings, in terms of the actual product and implementation of it procedurally, these advantages involve changes to current standard practices, such as using large clinical laboratories, that will require changes in both the procedures and mindset of care providers. The human medical market in particular is highly regulated, structured, difficult to penetrate and often slow to adopt new product offerings. If we are unable to convince large numbers of medical clinics, hospitals and other point-of-care environments of the benefits of our products, we will suffer lost sales and could fail to achieve anticipated revenue.

We are dependent upon our profitability, and if we cannot remain profitable we may need additional funding in the future and these funds may not be available to us.

We believe that our existing capital resources, available line of credit and anticipated revenue from the sales of our products will be adequate to satisfy our currently planned operating and financial requirements through the next twelve months, although no assurances can be given. The terms of our line of credit contain a number of covenants concerning financial tests that we must meet, and these tests are more fully explained herein under the subheading, Management s Discussion and Analysis of Financial Condition and Results of Operations.

Further, we expect to incur incremental additional costs to support our future operations, including:

- further commercialization of our products and development of new test methods to allow us to further penetrate the human diagnostic market and the veterinary diagnostic market;
- our need to acquire capital equipment for our manufacturing facilities, which includes the ongoing costs related to the continuing development of our current and future products;
- research and design costs related to the continuing development of our current and future products; and
- additional pre-clinical testing and clinical trials for our current and future products.

To the extent that our existing resources and anticipated revenue from the sale of our products are insufficient to fund our activities or if we are unable to meet the financial covenants of our line of credit, we may have to raise additional funds from the issuance of public or private securities. In the event that we cannot maintain compliance with these financial covenants, we may also be subject to increased interest rate expenses. We may not be able to raise additional funding, or if we are able to, we may not be able to raise funding on acceptable terms. We may also dilute then-existing shareholders if we raise additional funds by issuing new equity securities. Alternately, we may have to relinquish rights to certain of our technologies, products and/or sales territories if we are required to obtain funds through arrangements with collaborative partners. If we are unable to raise needed funds, we may be required to curtail our operations significantly. This would materially adversely affect our operating results and financial condition.

We rely on patents and other proprietary information, the loss of any would negatively affect our business.

As of September 30, 2006, 35 patent applications have been filed on behalf of Abaxis with the United States Patent and Trademark Office, of which 29 have been issued. Additionally, we have filed several international patent applications covering the same subject matter as our domestic applications. The patent position of any medical device manufacturer, including Abaxis, is uncertain and may involve complex legal and factual issues. Consequently, we may not be issued any additional patents, either domestically or internationally. Furthermore, our patents may not provide significant proprietary protection because there is a chance that they will be circumvented or invalidated. We cannot be certain that we were the first creator of the inventions covered by our issued patents or pending patent applications, or that we were the first to file patent applications for these inventions, because (1) the United States Patent and Trademark Office maintains all patent applications that are not filed in any foreign jurisdictions in secrecy until it issues the patents (unless a patent application owner files a request for publication) and (2) publications of discoveries in the scientific or patent literature tend to lag behind actual discoveries by several months. We may have to participate in interference proceedings, which are proceedings in front of the United States Patent and Trademark Office, to determine who will be issued a patent. These proceedings could be costly and could be decided against us.

We also rely upon copyrights, trademarks and unpatented trade secrets. Others may independently develop substantially equivalent proprietary information and techniques that would undermine our proprietary technologies. Further, others may gain access to our trade secrets or disclose such technology. Although we require our employees, consultants and advisors to execute agreements that require that our corporate information be kept confidential and that any inventions by these individuals are property of Abaxis, there can be no assurance that these agreements will provide meaningful protection or adequate remedies for our trade secrets in the event of unauthorized use or disclosure of such information. The unauthorized dissemination of our confidential information would negatively impact our business.

We must continue to develop our marketing and distribution experience in the human diagnostic market or our business will not grow.

Although we have gained experience marketing our VetScan system products in the veterinary diagnostic market, we have limited sales, marketing and distribution experience with our Piccolo systems in the human diagnostic market. Accordingly, we cannot assure you that:

we will be able to establish and maintain effective distribution arrangements in the human diagnostic market;

any distribution arrangements that we are able to establish will be successful in marketing our products; or

the costs associated with marketing and distributing our products will not be excessive.

Should we fail to effectively develop our marketing and distribution efforts, our growth will be limited and our results of operations will be adversely affected.

We may inadvertently produce defective products, which may subject us to significant warranty liabilities or product liability claims and we may have insufficient product liability insurance to pay material uninsured claims.

Our business exposes us to potential warranty and product liability risks which are inherent in the testing, manufacturing and marketing of human and veterinary medical products. We strive to apply sophisticated methods to raw materials and produce defect-free medical test equipment. Although we have established procedures for quality control on both the raw materials that we receive from suppliers and our manufactured final products, these procedures may prove inadequate to detect a defect that either occurs in limited quantities or that we have not anticipated. We believe that our Piccolo and VetScan systems detect the vast majority of errors that occur on our reagent discs and automatically reject such tests, prompting the medical provider to retest the patient. However, our Piccolo and VetScan systems may be unable to detect errors which could result in the misdiagnosis of human or veterinary patients.

Should we inadvertently ship defective products, we may be subject to substantial claims under our warranty policy or product liability law. In addition, our policy is to credit medical providers for any defective product that we produce, including those reagent discs that are rejected by our Piccolo and VetScan systems. Therefore, even if a mass defect within a lot or lots of reagent discs were detected by our Piccolo and VetScan systems, our need to replace such reagent discs free of charge would materially harm our financial condition. Further, in the event that a product defect is not detected by our Piccolo system, our relatively recent expansion into the human medical market greatly increases the risk that the amount of damages involved with just one product defect would be material to our operations. We currently maintain limited product liability insurance that we believe is adequate for our needs, taking into account the risks involved and cost of coverage. However, our product liability insurance and cash may be insufficient to cover potential liabilities. In addition, in the future the coverage that we require may be unavailable on commercially reasonable terms, if at all. Even with our current insurance coverage, a mass product defect, product liability claim or recall would materially adversely affect our business or our financial condition.

Many of our sales force have been employed by us for less than one year and we must effectively train and integrate our sales team in order to achieve our anticipated revenue or expand our business.

As of September 30, 2006, we have fifty-five full-time sales personnel involved in our sales and marketing activities, many of whom have been employed by us for a limited period of time. While these individuals work with our distribution partners both domestically and internationally to extend our market reach, the primary selling activities are often done by these individuals. If we are to increase our sales, we will need to train new sales personnel and supervise them closely. We also will continue hiring additional sales personnel. If we are unable to retain our existing personnel, or attract and train additional qualified personnel, our growth may be limited due to our lack of resources to market our products.

We need to successfully manufacture and market additional reagent discs for the human diagnostic market if we are to compete in that market.

We have developed a blood analysis system that consists of a portable blood analyzer and single-use reagent discs. Each reagent disc performs a series of standard blood tests. We believe that it is necessary to develop additional series of reagent discs with various tests for use with the Piccolo and VetScan systems. Historically, we have developed reagent discs suitable for the human medical and veterinary diagnostic markets. Abaxis has received 510(k) clearances from the FDA for 25 test methods in the human medical market. These tests are included in standard tests for which the medical community receives reimbursements from third party payors such as HMOs and Medicare. We may not be able to successfully manufacture or market these reagent discs. Our failure to meet these challenges will materially adversely affect our operating results and financial condition.

We rely on distributors to sell our products and we rely on sole distributor arrangements in a number of countries and failure to successfully maintain these relationships could adversely affect our ability to achieve our anticipated revenue or expand our business.

We sell our products primarily through distributors. As a result, we are dependent upon these distributors to sell our products and to assist us in promoting and creating a demand for our products. We operate on a purchase order basis with the distributors and the distributors are under no contractual obligation to continue carrying our products. Further, many of our distributors may carry our competitors products, and may promote our competitors products over our own products. One distributor, DVM Resources, accounted for 16% of total revenues for the three months ended September 30, 2006. Two distributors, Henry Schein, Inc. and DVM Resources, accounted for 16% and 14%, respectively, of total revenues for the three months ended September 30, 2005. One distributor, DVM Resources, accounted for 16% of total revenues for the six months ended September 30, 2006. Two distributors, DVM Resources and Henry Schein, Inc., accounted for 16% and 15%, respectively, of total revenues for the six months ended September 30, 2005.

We have a number of distributors in the United States who distribute our VetScan products. While we continue to enter into arrangements with veterinary distributors, we have also terminated our distribution relationships with the veterinary division of Henry Schein in May 2006 and Vedco, Inc. in December 2004. While we have in the past, and expect to in the future, support those customers who were previously supplied products by Henry Schein and Vedco, Inc. through our current distributor base and direct service, the loss of these or other distributors may negatively affect our future revenues. Accordingly, if one or more of our distributors were to stop selling our products in the future, we may experience a sharp decline in our sales revenue or we may experience a delay in our sales revenue.

In the United States medical market, we entered into formal distribution agreements with Henry Schein s Medical Group in the first quarter of fiscal 2007 and PSS World Medical, Inc. in the third quarter of fiscal 2006, to sell and market Piccolo systems and the medical reagent discs. Internationally, we have a few distributors for our products in both the human and veterinary diagnostic markets, which includes one distributor in Japan who received clearance in September 2005 from the Japanese regulatory agency to import and market our complete line of medical reagent discs, the Piccolo system, as well as all veterinary reagent discs, the VetScan system, with the exception of those products containing the Bile Acid assay. In July 2006, we received registration from TÜV SÜD Japan Ltd. for our Bile Acid test and we also received approval from the Ministry of Agriculture in Japan for marketin g and sale of the VetScan VS2 system in Japan.

We currently have distributors for our products in the following countries: Australia, Austria, Bahrain, Belgium, Canada, Denmark, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Korea, Kuwait, Macao, Malaysia, Mexico, the Netherlands, New Zealand, Norway, Portugal, Romania, Russia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, United Arab Emirates, the United Kingdom and the United States. Our distributor in each of these countries is responsible for obtaining the necessary approvals to sell our products. These distributors may not be successful in obtaining proper approvals for our products in their respective countries, and they may not be successful in marketing our products. We plan to continue to enter into additional distributor relationships to expand our international distribution base and solidify our international presence. However, we may not be successful in entering into additional distributor relationships. Our distributors may terminate their relationship with us at any time. Historically, we have experienced a turnover among our international distributors. This high degree of turnover makes it difficult for us to establish a steady distribution network overseas. Consequently, we may not be successful in marketing our Piccolo and VetScan products internationally.

We depend on sole suppliers for several key components in our products, many of whom we have not entered into contractual relationships with and failure of our suppliers to provide the materials to us could harm our business.

We use several key components that are currently available from limited or sole sources as discussed below:

Reagent Discs: Two injection molding manufacturers, C. Brewer & Co. and Nypro Oregon, Inc., currently make the molded plastic discs which, when loaded with reagents and welded together, form our reagent disc products. We believe that only a few manufacturers are capable of producing these discs to the narrow tolerances that we require. To date, we have only qualified these two manufacturers, with Nypro Oregon, Inc. being qualified at two separate facilities, to manufacture the molded plastic discs.

Reagent Chemicals: We currently depend on the following single source vendors for some of the chemicals that we use to produce the dry reagent chemistry beads that are either inserted in our reagent discs or sold as a stand-alone product: Amano Enzyme USA Co., Ltd., Genzyme Corporation, Kikkoman Corporation Biochemical Division, Microgenics Corporation, Roche Molecular Biochemicals of Roche Diagnostics Corporation, a division of F. Hoffmann-La Roche, Ltd., Shinko American Inc. and Sigma Aldrich Inc.

Blood Analyzer Components: Our analyzer products use several technologically advanced components that we currently purchase from the following single source vendors, Electro Alliance, Inc., PerkinElmer, Inc., and UDT Sensors. Our analyzers use a printer that is only made by Seiko North America Corporation. The loss of the supply of any of these components could force us to redesign our analyzers.

Hematology Instruments and Reagents: The VetScan HMII is manufactured by Diatron in Hungary and is purchased by us as a completed instrument. To date, we have qualified two suppliers to produce the reagents for the hematology instruments: Clinical Diagnostic Solutions, Inc. and Mallinckrodt Baker BV.

For our hematology instruments purchased from Diatron, we are subject to minimum purchase requirements through fiscal 2008. The terms of the minimum purchase requirements are more fully explained in the Notes to the Condensed Financial Statements. We operate on a purchase order basis with all of the suppliers of our molded plastic reagent discs, reagent chemicals and blood analyzer components and thus these suppliers are under no contractual obligation to supply us with their products or to do so at specified prices. Although we believe that there are potential alternate suppliers available for these critical components, to date we have not qualified additional vendors beyond those referenced above.

Because we are dependent on a limited number of suppliers and manufacturers for critical components to our products, we are particularly susceptible to any interruption in the supply of these products or the viability of our assembly arrangements. The loss of any one of these suppliers or a disruption in our manufacturing arrangements could materially adversely affect our business and financial condition.

We compete with larger, better established entities such as hospitals and commercial laboratories, which could cause our sales to decline if we cannot compete effectively.

Blood analysis is a well established field in which there are a number of competitors that have substantially greater financial resources and larger, more established marketing, sales and service organizations than we do. We compete with the following organizations:

commercial clinical laboratories;

hospitals clinical laboratories; and

manufacturers of bench top multi-test blood analyzers and other testing systems that health care providers can use on-site.

We may not be able to compete effectively with larger, better established entities or their products or with future organizations or future products which could cause our sales to decline.

Historically, hospitals and commercial laboratories performed most human diagnostic testing, and commercial laboratories performed most veterinary medical testing. We have identified five principal factors that customers typically use to evaluate our products and those of our competitors. These factors are:

range of tests offered;

the immediacy of results;

cost effectiveness;

ease of use; and

reliability of results.

We believe that we compete effectively on each of these factors except for the range of tests offered. Clinical laboratories are effective at processing large panels of tests using skilled technicians and complex equipment. While our current offering of reagent discs cannot provide the same broad range of tests, we believe that in certain markets our products provide a sufficient breadth of test menus to compete successfully with clinical laboratories given the advantages of our products with respect to the other four factors. However, we cannot assure you that we will continue to be able to compete effectively on cost effectiveness, ease of use, immediacy of results or reliability of results. We also cannot assure you that we will ever be able to compete effectively on the basis of range of tests offered.

Competition in the human and veterinary diagnostic markets is intense. Our principal competitors in the human diagnostic market are Alfa Wassermann S.P.A., i-STAT Corporation (which was purchased by Abbott Laboratories), Johnson & Johnson (including its subsidiary, Ortho-Clinical Diagnostics, Inc.) and Polymedco. Our principal competitors in the veterinary diagnostic market are Idexx Laboratories, Inc. and Heska Corporation. Most of our competitors have significantly greater financial and other resources than we do. In particular, many of our competitors have large sales forces and well-established distribution channels. Consequently, we must develop our distribution channels and improve our direct sales force in order to compete in these markets.

Changes in third party payor reimbursement regulations can negatively affect our business.

By regulating the maximum amount of reimbursement they will provide for blood testing services, third party payors, such as HMOs, pay-per-service insurance plans, Medicare and Medicaid, can indirectly affect the pricing or the relative attractiveness of our human testing products. For example, the Centers for Medicare and Medicaid Services (CMS) sets the level of reimbursement of fees for blood testing services for Medicare beneficiaries. If third party payors decrease the reimbursement amounts for blood testing services, it may decrease the amount that physicians and hospitals are able to charge patients for such services. Consequently, we will need to charge less for our products. If the government and third party payors do not provide for adequate coverage and reimbursement levels to allow health care providers to use our products, the demand for our products will decrease.

We are subject to numerous governmental regulations and any regulatory changes are difficult to predict and may be damaging to our business.

Need for FDA Certification for Our Medical Device Products

Our Piccolo products are regulated under the 1976 Medical Device Amendments to the Food, Drug and Cosmetic Act, which is administered by the Food and Drug Administration (FDA). The FDA has classified our Piccolo products as Class I and Class II devices. These classifications require us to submit to the FDA a pre-market notification form or 510(k). The FDA uses the 510(k) to substantiate product claims that are made by medical device manufacturers prior to marketing. In our 510(k) notification, we must, among other things, establish that the product we plan to market is substantially equivalent to (1) a product that was on the market prior to the adoption of the 1976 Medical Device Amendment or (2) a product that the FDA has previously cleared under the 510(k) process.

The FDA review process of a 510(k) notification can last anywhere from three to six months, and the FDA must issue a written order finding substantial equivalence before a company can market a medical device. As of September 30, 2006, we have received market clearance from the FDA for our Piccolo system and 25 reagent tests that we have on 12 reagent discs. We are currently developing additional tests that the FDA will have to clear through the 510(k) notification procedures. These new test products are crucial for our success in the human medical market. If we do not receive 510(k) clearance for a particular product, we will not be able to sell that product in the United States.

Need to Comply with Manufacturing Regulations

The 1976 Medical Device Amendment also requires us to manufacture our Piccolo products in accordance with Good Manufacturing Practices guidelines. Current Good Manufacturing Practice requirements are set forth in the 21 CFR 820 Quality System Regulation. These requirements regulate the methods used in, and the facilities and controls used for the design, manufacture, packaging, storage, installation and servicing of our medical devices intended for human use. Our manufacturing facility is subject to periodic inspections. Although we have obtained a license from the State of California to manufacture our products, various state regulatory agencies may regulate the manufacture of our products. To date, we have complied with the following:

In April 2001, the State of California Food and Drug Branch granted our manufacturing facility in compliance status, based on the regulations for Good Manufacturing Practices for medical devices.

In May 2001, the State of California Food and Drug Branch granted licensing for our manufacturing facility in Union City, California.

In May 2002, we received our ISO 9001 certification, expanding our compliance with international quality standards.

In December 2003, we received ISO 13485 Quality System certification as required by the 2003 European In Vitro Device Directive. This certified our quality system specifically to medical devices.

In both September 2005 and March 2003, the U.S. FDA conducted a facility inspection and verified our compliance with the 21 CFR 820 Regulation.

We cannot assure you that we will successfully pass a re-inspection by the U.S. FDA or the State of California. In addition, we cannot assure you that we can comply with all current or future government manufacturing requirements and regulations. If we are unable to comply with the regulations, or if we do not pass routine inspections, our business and results of operations will be materially adversely affected.

Effects of the Clinical Laboratory Improvement Amendments on Our Products

Our Piccolo products are affected by the Clinical Laboratory Improvement Amendments (CLIA) of 1988. The Clinical Laboratory Improvement Amendments (CLIA) are intended to insure the quality and reliability of all medical testing in the United States regardless of where tests are performed. The current Clinical Laboratory Improvement Amendments (CLIA) divide laboratory tests into three categories: simple, moderately complex and highly complex. Many of the tests performed using the Piccolo system are in the moderately complex category. This category requires that any location in which testing is performed be certified as a laboratory. Hence, we can only sell some Piccolo products to customers who meet the standards of a laboratory. To receive laboratory certification, a testing facility must be certified by the Centers for Medicare and Medicaid Services (CMS). After the testing facility receives a laboratory certification, it must then meet the Clinical Laboratory Improvement Amendments (CLIA) regulations. Because we can only sell some Piccolo products to testing facilities that are certified laboratories, the market for some products is correspondingly constrained.

In October 2006, the FDA granted waived status under CLIA regulations for the following six additional analytes: albumin (ALB), alkaline phosphatase (ALP), amylase (AMY), gamma glutamyltransferase (GGT), total bilirubin (TBIL) and total protein (TP), when used in conjunction with the Piccolo point-of-care analyzer for the medical market. Accordingly, we can offer the Liver Panel Plus, along with the Lipid Panel and Lipid Panel Plus as waived tests to the medical market. The tests included on our Lipid Panel and Lipid Panel Plus reagent discs have been granted waived status under CLIA regulations for our total cholesterol, HDL, triglycerides, glucose, ALT and AST tests when used in conjunction with our Piccolo system. Waived status permits untrained personnel to run the Piccolo system using the Liver Panel Plus, Lipid Panel and Lipid Panel Plus; thus, extending the sites (doctors offices and other point-of-care environments) that can use the Piccolo system.

We cannot assure you that we will successfully receive the waived status from the FDA for other products. Consequently, for the reagent discs that have not received CLIA waived status, the market for our Piccolo products may be confined to those testing facilities that are certified as laboratories and our growth can be limited accordingly. However, we are engaged in an active program to test and apply for CLIA waiver for additional analytes.

We Are Subject to Various Federal, State, Local, and International Regulations

Federal, state, local and international regulations regarding the manufacture and sale of health care products and diagnostic devices may change. In addition, as we continue to sell in foreign markets, we may have to obtain additional governmental clearances in those markets. We have received the following certifications:

In December 2003, we received certification from the British Standards Institute to the ISO 13485:1996 quality system standard for medical devices. This quality system certification, along with successful completion of product testing to 2003 European standards and the translation of Piccolo product documentation into the required languages, enabled us to meet the compliance requirements of the CE Mark and the 2003 European In Vitro Device Directive.

In September 2005, we received the Canadian Medical Device Conformity Assessment System (CMDCAS) stamp on our ISO 13485 certificate to signify compliance with Health Canada regulations.

In March 2006, we received our certification to the 2003 version of the ISO 13485 quality system standard for medical devices.

In July 2006, we received registration from TÜV SÜD Japan Ltd. for our Bile Acid test in Japan.

In July 2006, we received approval from the Ministry of Agriculture in Japan for marketing and sale of the VetScan VS2 system in Japan.

We cannot predict what impact, if any, such current or future regulatory changes would have on our business. We may not be able to obtain regulatory clearances for our products in the United States or in foreign markets, and the failure to obtain these regulatory clearances will materially adversely affect our business and results of operations.

Although we believe that we will be able to comply with all applicable regulations of the Food and Drug Administration and of the State of California, including the Quality System Regulation, current regulations depend on administrative interpretations. Future interpretations made by the Food and Drug Administration, the Centers for Medicare and Medicaid Services (CMS) or other regulatory bodies may adversely affect our business.

We depend on key members of our management and scientific staff, and we must retain and recruit qualified individuals if we are to be competitive or our ability to execute our business strategy and generate sales could be harmed.

We are highly dependent on the principal members of our management and scientific staff. The loss of any of these key personnel, including in particular Clinton H. Severson, our President, Chief Executive Officer and Chairman of our Board of Directors, might impede the achievement of our business objectives. Mr. Severson s amended and restated employment agreement with us has been filed with the Securities and Exchange Commission as an exhibit. We currently do not maintain key man life insurance on any of our employees. Although historically we have been relatively successful both in retaining our current management and scientific staff, as well as attracting and retaining skilled and experienced marketing, sales and manufacturing personnel, we may not be able to employ such personnel on acceptable terms in the future because numerous medical products and other high technology companies compete for the services of these qualified individuals.

Standards for compliance with Section 404 of the Sarbanes-Oxley Act of 2002 are complex, and if we are unable to maintain effective internal control over our financial reporting, our business could be harmed and our stock price could decline.

Rules adopted by the Securities and Exchange Commission pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 require an annual assessment of internal control over financial reporting by Abaxis management and an attestation of its assessment by independent registered public accountants. The standards that must be met for management to assess the internal control over financial reporting as effective are new and complex, require significant documentation, testing and possible remediation to meet the detailed standards.

Abaxis management assessed the effectiveness of its internal control over financial reporting as of its fiscal years ended March 31, 2006 and 2005. The assessment for fiscal 2005 identified a material weakness in its internal control over financial reporting related to ineffective controls over the determination and reporting of the provision for income taxes. The control deficiency identified in fiscal 2005 could have resulted in a future material misstatement of our income tax provision (and related balance sheet accounts) that would not have been prevented or detected by management. Although Abaxis received an unqualified opinion on its financial statements for the fiscal year ended March 31, 2006, and on the effectiveness of its internal control over financial reporting, the steps Abaxis has taken to date and the steps Abaxis is still in the process of taking to improve the reliability of its financial statements in the future are subject to continued management review, as well as oversight by the audit committee of its board of directors. Any failure to implement required new or improved controls, or difficulties encountered in implementation could harm operating results or prevent us from accurately reporting financial results or cause a failure by Abaxis to meet its reporting obligations in the future. If our management cannot assess Abaxis internal control over financial reporting as effective, or our independent registered public accounting firm is unable to provide an unqualified attestation report on such assessment, investor confidence and share value may be negatively impacted.

Potential new accounting pronouncements may impact our future financial position or results of operations.

Future changes in financial accounting standards, including new changes in accounting for employee share-based awards, may cause adverse, unexpected fluctuations in the timing of the recognition of revenues or expenses and may affect our financial position or results of operations. New pronouncements and varying interpretations of pronouncements have occurred and are expected to continue to occur frequently, and we may make changes in our accounting policies in the future. As a result, we intend to invest significant resources to comply with evolving standards, and this investment may result in increased general and administrative expenses.

Our operating results could be materially affected by unanticipated changes in our tax provisions or exposure to additional income tax liabilities.

Our determination of our tax liability (like any company s determination of its tax liability) is subject to review by applicable tax authorities. Any adverse outcome of such a review could have an adverse effect on our operating results and financial condition. In addition, the determination of our provision for income taxes and other tax liabilities requires significant judgment including our determination of whether a valuation allowance against deferred tax assets is required. Although we believe our estimates and judgments are reasonable, the ultimate tax outcome may differ from the amounts recorded in our financial statements and may materially affect our financial results in the period or periods for which such determination is made.

We must comply with strict and potentially costly environmental regulations or we could pay significant fines.

We are subject to stringent federal, state and local laws, rules, regulations and policies that govern the use, generation, manufacture, storage, air emission, effluent discharge, handling and disposal of certain materials and wastes. In particular, we are subject to laws, rules and regulations governing the handling and disposal of biohazardous materials used in the development and testing of our products. We handle and dispose of human and veterinary blood samples for testing (whole blood, plasma, serum) and we paid approximately $54,000 in fiscal 2006 to comply with applicable environmental regulations. Although we believe that we have complied with applicable laws and regulations in all material respects and have not been required to take any action to correct any noncompliance, we may have to incur significant costs to comply with environmental regulations if our manufacturing to commercial levels continues to increase. In addition, if a government agency determines that we have not complied with these laws, rules and regulations, we may have to pay significant fines and/or take remedial action that would be expensive and we do not carry environmental-related insurance coverage.

Our facilities and manufacturing operations are vulnerable to natural disasters and other unexpected losses; system failures or delays may harm our business.

Our success depends on the efficient and uninterrupted operation of our manufacturing operations, which are co-located with our corporate headquarters in Union City, California. A failure of manufacturing operations, be it in the development and manufacturing of our Piccolo or VetScan analyzers or the reagent discs used in the analyzers, could result in our inability to supply customer demand.

We do not have a backup facility to provide redundant manufacturing capacity in the event of a system failure. Accordingly, if our Union City location experienced a system failure, or regulatory problem that temporarily shut-down our manufacturing facility, our manufacturing ability would become unavailable until we were able to bring an alternative facility online, a process which could take several weeks or even months. These manufacturing operations are also vulnerable to damage from earthquakes, fire, floods, power loss, telecommunications failures, break-ins and similar events. Although we carry property and business interruption insurance, our coverage may not be adequate to compensate us for all losses that may occur. Additionally, our computer servers may be vulnerable to computer viruses, physical or electronic break-ins and similar disruptions.

Fluctuations in foreign exchange rates and the possible lack of financial stability in foreign countries could prevent overseas sales growth.

Our international sales are overwhelmingly currently U.S. dollar-denominated. As a result, an increase in the value of the U.S. dollar relative to foreign currencies could make our products less competitive in international markets. For the limited amount of our sales denominated in local currencies, we are subject to fluctuations in exchange rates between the U.S. dollar and the particular local currency. Our operating results could also be adversely affected by the seasonality of international sales and the economic conditions of our overseas markets.

Our stock price is highly volatile and investing in our stock involves a high degree of risk, which could result in substantial losses for investors.

The market price of our common stock, like the securities of many other medical products companies, fluctuates over a wide range, and will continue to be highly volatile in the future. During the past two years, our stock price closed at a high of $26.12 on April 28, 2006 and a low of $7.62 on April 22, 2005. The following factors may affect the market price of our common stock:

fluctuation in our operating results;

announcements of technological innovations or new commercial products by us or our competitors;

changes in governmental regulation;

prospects and proposals for health care reform;

governmental or third party payors controls on prices that our customers may pay for our products;

developments or disputes concerning patent or our other proprietary rights;

public concern as to the safety of our devices or similar devices developed by our competitors; and

general market conditions.

Because our stock price is so volatile, investing in our common stock is highly risky. A potential investor must be able to withstand the loss of his entire investment in our common stock.

Our Shareholders Rights Plan and our ability to issue preferred stock may delay or prevent a change of control of Abaxis.

Our Shareholder Rights Plan, adopted by our Board of Directors on April 22, 2003, may make it more difficult for a third party to acquire, or discourage a third party from attempting to acquire control of Abaxis. The Shareholder Rights Plan could limit the price that investors might be willing to pay in the future for shares of our common stock.

In addition, our Board of Directors has the authority to issue up to 5,000,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by the shareholders, except to the extent required by NASDAQ rules. The issuance of preferred stock, while providing flexibility in connection with possible financings or acquisitions or other corporate purposes, could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to the impact of interest rate changes with respect to our line of credit and our short-term investments.

For our line of credit, which provides for borrowings of up to $2,000,000, the interest rate is equal to the bank s prime rate minus 0.25%, which totaled 8.00% at September 30, 2006. Consequently, an increase in the prime rate would expose us to higher interest expenses. At September 30, 2006, there was no amount outstanding on our line of credit.

We invest excess cash in cash equivalents and in various types of short-term investments. Our investment objective is to maximize yields without significantly increased risk. At September 30, 2006, our short-term investments totaled $26,870,000, which includes net unrealized gains of $225,000. The short-term investments consisted of corporate obligations and auction rate securities, with maturities of one year or less from the date of purchase.

As a matter of management policy, we do not currently enter into transactions involving derivative financial instruments. In the event we do enter into such transactions in the future, such items will be accounted for in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, in which case we will formally document all relationships between hedging instruments and hedged items, as well as our risk management objective and strategy for undertaking such hedge transactions.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. Based on our management s evaluation, with the participation of our principal executive officer and principal financial officer, as of the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the Exchange Act), were effective to ensure that information required to be disclosed by us in reports that 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.

Changes in Internal Control over Financial Reporting. During the quarter ended September 30, 2006, there has been no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are involved from time to time in various litigation matters in the normal course of business. We believe that the ultimate resolution of these matters will not have a material effect on our financial position or results of operations.

Item 1A. Risk Factors

Other than with respect to the risk factors below, there have been no material changes from the risk factors disclosed in the Risk Factors section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2006 as filed with the Securities and Exchange Commission on June 14, 2006. The two risk factors below were added in the quarterly period to address (i) the potential impact of future changes in accounting pronouncements and (ii) risks associated with unanticipated changes in the Company s tax provisions or exposure to additional income tax liabilities.

Potential new accounting pronouncements may impact our future financial position or results of operations.

Future changes in financial accounting standards, including new changes in accounting for employee share-based awards, may cause adverse, unexpected fluctuations in the timing of the recognition of revenues or expenses and may affect our financial position or results of operations. New pronouncements and varying interpretations of pronouncements have occurred and are expected to continue to occur frequently, and we may make changes in our accounting policies in the future. As a result, we intend to invest significant resources to comply with evolving standards, and this investment may result in increased general and administrative expenses.

Our operating results could be materially affected by unanticipated changes in our tax provisions or exposure to additional income tax liabilities.

Our determination of our tax liability (like any company s determination of its tax liability) is subject to review by applicable tax authorities. Any adverse outcome of such a review could have an adverse effect on our operating results and financial condition. In addition, the determination of our provision for income taxes and other tax liabilities requires significant judgment including our determination of whether a valuation allowance against deferred tax assets is required. Although we believe our estimates and judgments are reasonable, the ultimate tax outcome may differ from the amounts recorded in our financial statements and may materially affect our financial results in the period or periods for which such determination is made.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

Exhibit No.	Description of Document
10.22	Amendment, dated September 21, 2006, to the Manufacturing and Supply Agreement by and between Diatron Messtechnik GmbH and Abaxis, dated November 13, 2003. +
10.23	Distribution Agreement by and between Walco International, Inc. (d/b/a DVM Resources) and Abaxis, dated April 1, 2006. +
31.1	Certification of President and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2	Certification of Chief Financial Officer and Vice President of Finance pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of President and Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer and Vice President of Finance pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

+ Confidential treatment of certain portions of this agreement has been requested from the Securities and Exchange Commission.

SIGNATURES

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.

ABAXIS, INC.
(Registrant)

Date: November 9, 2006

BY: /s/ Clinton H. Severson

Clinton H. Severson
President, Chief Executive Officer and Director
(Principal Executive Officer)

Date: November 9, 2006

BY: /s/ Alberto R. Santa Ines

Alberto R. Santa Ines
Chief Financial Officer and Vice President of Finance
(Principal Financial and Accounting Officer)