ABAXIS INC
Form 10-Q
August 08, 2008

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

(Mark One)

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2008

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 þ No o

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Yes o No þ

As of August 6, 2008, there were 21,782,000 shares of the Registrant s common stock outstanding.

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Exhibit 32.2

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Financial Statements (Unaudited)

ABAXIS, INC.
CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except share and per share data)

	Three Months Ended June 30,	
	2008	**2007**
Revenues	$ 24,572	$ 22,931
Cost of revenues	11,069	9,915
Gross profit	13,503	13,016
Operating expenses:		
Research and development	1,997	1,653
Sales and marketing	5,827	5,229
General and administrative	1,662	1,651
Total operating expenses	9,486	8,533
Income from operations	4,017	4,483
Interest and other income (expense), net	462	499
Income before income taxes	4,479	4,982
Income tax provision	1,703	1,884
Net income	$ 2,776	$ 3,098
Net income per share:		
Basic net income per share	$ 0.13	$ 0.15
Diluted net income per share	$ 0.12	$ 0.14
Shares used in the calculation of net income per share:		
Weighted average common shares outstanding basic	21,735,000	21,311,000
Weighted average common shares outstanding diluted	22,398,000	22,102,000
Share-based compensation expense by function:		
Cost of revenues	$ 35	$ 20
Research and development	61	35

Sales and marketing	137	80
General and administrative	168	122
Total share-based compensation expense	$ 401	$ 257

See accompanying Notes to the Unaudited Condensed Financial Statements.

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ABAXIS, INC.
CONDENSED BALANCE SHEETS
(Unaudited)
(In thousands, except share data)

	June 30, 2008	March 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 23,031	$ 17,219
Short-term investments	6,991	6,991
Trade receivables (net of allowances of $305 at June 30, 2008 and $272 at March 31, 2008)	20,952	20,873
Inventories, net	18,358	18,657
Prepaid expenses	1,190	427
Net deferred tax asset current	2,760	2,426
Total current assets	73,282	66,593
Long-term investments	31,559	35,463
Property and equipment, net	14,727	14,599
Intangible assets, net	356	375
Other assets		5
Net deferred tax asset non-current	3,855	3,868
Total assets	$ 123,779	$ 120,903
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 4,808	$ 6,421
Accrued payroll and related expenses	3,447	4,277
Other accrued liabilities	1,209	1,369
Deferred revenue	875	807
Warranty reserve	1,108	1,219
Total current liabilities	11,447	14,093
Non-current liabilities:		
Deferred rent	251	286
Deferred revenue	1,409	1,146
Warranty reserve	1,007	729
Total non-current liabilities	2,667	2,161
Commitments and contingencies (Note 8)		

Shareholders equity:		
Preferred stock, no par value; 5,000,000 shares authorized; no shares issued and outstanding		
Common stock, no par value; 35,000,000 shares authorized; 21,768,000 and 21,706,000 shares issued and outstanding at June 30, 2008 and at March 31, 2008, respectively	111,188	109,031
Accumulated deficit	(191)	(2,967)
Accumulated other comprehensive loss	(1,332)	(1,415)
Total shareholders equity	109,665	104,649
Total liabilities and shareholders equity	$ 123,779	$ 120,903

See accompanying Notes to the Unaudited Condensed Financial Statements.

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ABAXIS, INC.
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Three Months Ended June 30,	
	2008	**2007**
Cash flows from operating activities:		
Net income	$ 2,776	$ 3,098
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,004	810
(Gain) loss on disposal of property and equipment	(20)	2
Share-based compensation expense	401	257
Excess tax benefits from share-based awards	(1,773)	(119)
Deferred income taxes	1,439	1,682
Changes in assets and liabilities:		
Trade receivables, net	(79)	1,581
Inventories, net	(296)	(2,142)
Prepaid expenses	(763)	386
Other assets	5	9
Accounts payable	(1,613)	(952)
Accrued payroll and related expenses	(830)	(778)
Other accrued liabilities	(160)	(78)
Deferred rent	(35)	(24)
Deferred revenue	331	(247)
Warranty reserve	167	63
Net cash provided by operating activities	554	3,548
Cash flows from investing activities:		
Purchases of available-for-sale investments		(14,675)
Purchases of held-to-maturity investments	(6,991)	(9,240)
Proceeds from redemptions of available-for-sale investments	4,000	
Proceeds from maturities of held-to-maturity investments	6,991	18,628
Purchases of property and equipment	(524)	(721)
Proceeds from disposal of property and equipment	20	
Net cash provided by (used in) investing activities	3,496	(6,008)
Cash flows from financing activities:		
Proceeds from issuance of common stock under stock plans, net	(11)	1,317
Excess tax benefits from share-based awards	1,773	119
Net cash provided by financing activities	1,762	1,436

Net increase (decrease) in cash and cash equivalents		5,812		(1,024)
Cash and cash equivalents at beginning of period		17,219		10,183
Cash and cash equivalents at end of period	$	23,031	$	9,159
Supplemental disclosure of cash flow information:				
Cash paid for interest	$		$	4
Cash paid for income taxes, net of refunds	$	144	$	18
Supplemental disclosure of non-cash flow information:				
Change in unrealized gain (loss) on investments, net of tax	$	83	$	
Transfers of equipment between inventory and property and equipment	$	589	$	280
Capitalized share-based compensation	$	(6)	$	7
Common stock withheld for employee taxes in connection with share-based compensation	$	229	$	90

See accompanying Notes to the Unaudited Condensed Financial Statements.

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ABAXIS, INC.
NOTES TO THE UNAUDITED CONDENSED FINANCIAL STATEMENTS

NOTE 1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Description of Business. Abaxis, Inc. (the Company), incorporated in California in 1989, develops, manufactures, markets and sells portable blood analysis systems for use in the human or veterinary 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 (the SEC). 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 three month period ended June 30, 2008 are not necessarily indicative of the results to be expected for the entire fiscal year ending March 31, 2009 or for any future period.

These unaudited condensed financial statements should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and 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, 2008.

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 or financial position.

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, fair value of investments, sales and other allowances, inventory reserves, income taxes, valuation allowance for deferred tax assets, share-based compensation and warranty reserves. Actual results may differ from these estimates.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

In March 2008, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards (SFAS) SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS No. 161), which is intended to enable investors to better understand how derivative instruments and hedging activities affect an entity s financial position, financial performance and cash flows through enhanced disclosure requirements. SFAS No. 161 will be effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. SFAS No. 161 will become effective for the Company on April 1, 2009. The Company is currently evaluating the impact of adopting SFAS No. 161 on its financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS No. 141(R)). SFAS No. 141(R) will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. SFAS No. 141(R) will become effective for the Company on April 1, 2009. The Company is currently evaluating the impact of adopting SFAS No. 141(R) on its financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 (SFAS No. 160), which establishes new accounting and reporting standards for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS No. 160 will become effective for the Company on April 1, 2009. The Company is currently evaluating the impact of adopting SFAS No. 160 on its financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159). SFAS No. 159 permits entities to choose, at specified election dates, to measure eligible items at fair value (the fair value option). Unrealized gains and losses on instruments for which the fair value option has been elected are reported in earnings at each subsequent reporting period. SFAS No. 159 is applied prospectively upon adoption. The Company adopted SFAS No. 159 effective April 1, 2008. The Company did not elect the fair value option for any of its financial assets or financial liabilities.

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NOTE 3. FAIR VALUE MEASUREMENTS

On April 1, 2008, the Company adopted SFAS No. 157, Fair Value Measurements (SFAS No. 157) to measure the fair value of its financial assets and financial liabilities. In February 2008, the FASB issued FSP FAS 157-2 Effective Date of FASB Statement No. 157 (FSP 157-2) which delayed the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. The adoption of SFAS No. 157 for financial assets and liabilities did not have a material impact on the Company s financial position, cash flows or results of operations.

SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 establishes a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity s own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy under SFAS No. 157 are described below:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Directly or indirectly observable market based inputs used in models or other valuation methodologies.

Level 3: Unobservable inputs that are supported by little or no market data and require the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management s estimates of market participant assumptions.

The following table summarizes financial assets, measured at fair value on a recurring basis, by level within the fair value hierarchy as of June 30, 2008 (in thousands):

	As of June 30, 2008			
	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total
Assets				
Cash and cash equivalents(1)	$ 23,031	$	$	$ 23,031
Short-term investments:				
Certificate of deposits	6,991			6,991
Long-term investments:				
Auction rate securities			31,559	31,559
Total assets at fair value	$ 30,022	$	$ 31,559	$ 61,581

(1) Cash and cash equivalents as of June 30, 2008 consisted of $12.6 million in

cash and $10.4 million in cash equivalents, consisting of money market mutual funds.

The fair value of the Company s Level 1 financial assets are based on quoted market prices of the underlying security. As of June 30, 2008, the Company did not have any Level 2 financial assets or liabilities.

Assets measured at fair value on a recurring basis using significant unobservable Level 3 inputs consist of auction rate securities. As of June 30, 2008, the Company held $33.0 million par value of investments in auction rate securities that were structured to periodically reset through auctions ranging from seven to 28 days. As of June 30, 2008, $29.4 million par value of the Company s auction rate securities were collateralized by municipal bonds and the remaining $3.6 million par value of the Company s auction rate securities were collateralized by a variety of securities, including real estate income trust, preferred stock, convertible preferred stock, high yield bonds, high dividend equities or other stock. All of these investments in auction rate securities were rated AAA and the Company continues to earn interest on its auction rate securities at the contractual rate.

Until February 2008, the market for the Company s auction rate securities was highly liquid. Starting in February 2008, the auctions on the Company s auction rate securities began to fail because the amount of securities submitted for sale began to exceed the amount of purchase orders for such securities. The credit market has not materially improved and auctions on the Company s auction rate securities continue to fail. As a result, the Company will not be able to access these funds until future auctions for these securities are successful, until a secondary market is established, or until these securities are called for redemption. When an auction fails, the estimated fair value of these investments no longer approximates par value. Accordingly, the Company s auction rate securities were classified as long-term investments at March 31, 2008 and at June 30, 2008 on its balance sheet because of the Company s inability to determine when its investments in auction rate securities would be sold. At June 30, 2008, the fair value of the Company s auction rate securities was $31.6 million. During the three months ended June 30, 2008, $4.0 million of the Company s auction rate securities were redeemed at 100% of par value by the issuer of the auction rate securities.

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At June 30, 2008, observable market information related to auction rate securities was not available to determine the fair value of the Company s investments. Therefore, the Company estimated fair value using valuation models that relied on Level 3 inputs to value the securities, including expected future cash flows, market rate of return, term to maturity, assessment of credit quality and overall capital market liquidity. The valuation of the auction rate securities is subject to uncertainties that are difficult to predict and require significant judgment. Factors that may impact the Company s valuation in the future include, changes to credit ratings of the securities, changes to the underlying assets supporting the auction rate securities, rates of default of the underlying assets, discount rates, strength and quality of the credit market and liquidity.

The following table summarizes the changes in the carrying value associated with Level 3 financial assets for the three months ended June 30, 2008 (in thousands):

	Auction Rate Securities
Balance at March 31, 2008	$ 35,463
Redemptions during the period	(4,000)
Transfers	
Total gain or loss (realized or unrealized)	
Included in earnings (loss)	
Included in other comprehensive loss	96
Balance at June 30, 2008	$ 31,559

NOTE 4. INVESTMENTS

The following table summarizes, by major security type, the cost and fair value of investments (in thousands):

	June 30, 2008		
	Cost	Unrealized Gain (Loss)	Fair Value
Short-term investments			
Held-to-maturity:			
Certificate of deposits	$ 6,991	$	$ 6,991
Total short-term investments in held-to-maturity	$ 6,991	$	$ 6,991
Long-term investments			
Available-for-sale:			
Auction rate securities	$ 32,975	$ (1,416)	$ 31,559
Total long-term investments in available-for-sale	$ 32,975	$ (1,416)	$ 31,559

	March 31, 2008		
	Cost	Unrealized Gain (Loss)	Fair Value
Short-term investments			
Held-to-maturity:			
Certificate of deposits	$ 2,974	$	$ 2,974
Municipal bonds	4,017		4,017

Total short-term investments in held-to-maturity	$ 6,991	$	$ 6,991
Long-term investments			
Available-for-sale:			
Auction rate securities	$ 36,975	$ (1,512)	$ 35,463
Total long-term investments in available-for-sale	$ 36,975	$ (1,512)	$ 35,463

As of June 30, 2008 and March 31, 2008, unrealized loss on investments, net of related income taxes, was $1.3 million and $1.4 million, respectively.

At June 30, 2008, the contractual maturities for certificate of deposits were less than one year. The Company determined that its auction rate securities were not liquid at June 30, 2008 and March 31, 2008 since several auctions related to its auction rate securities failed beginning in February 2008. Accordingly, the Company s auction rate securities were classified as long-term at June 30, 2008 and March 31, 2008 even though the stated maturity dates may be less than one year from the balance sheet date.

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NOTE 5. INVENTORIES, NET

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, were as follows (in thousands):

	June 30, 2008	March 31, 2008
Raw materials	$ 10,367	$ 9,067
Work-in-process	2,963	4,315
Finished goods	5,028	5,275
Inventories, net	$ 18,358	$ 18,657

NOTE 6. WARRANTY RESERVES

The Company provides for the estimated future costs to be incurred under the Company s standard warranty obligation on its instruments. Starting on July 1, 2007, the Company provides for the estimated future costs to be incurred under the Company s warranty obligation on its reagent discs as part of warranty reserves. Prior to July 1, 2007, the Company maintained a provision for defective reagent discs as part of sales allowances.

Instruments. Since the beginning of fiscal 2006, the Company s standard warranty obligation on instruments is two years. The estimated contractual warranty obligation is recorded when the related revenue is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated. The estimated accrual for warranty exposure is based on historical experience, estimated product failure rates, material usage, freight incurred in repairing the instrument after failure and known design changes.

Reagent Discs. Beginning on July 1, 2007, the Company records a provision for defective reagent discs when the related sale is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated. The warranty cost includes the replacement costs and freight of a defective reagent disc. Prior to July 1, 2007, the Company recorded a provision for defective reagent discs as part of sales allowances since the Company primarily issued a credit to customers for defective reagent discs. Starting on July 1, 2007, the provision for defective reagent discs is recorded as part of warranty reserves, since the Company replaces defective reagent discs rather than issue a credit to customers. The change did not have a material impact on the Company s financial statements. During the three months ended June 30, 2008, the provision for warranty expense related to replacement of defective reagent discs was $77,000 and at June 30, 2008, the balance of accrued warranty reserve related to replacement of defective reagent discs was $407,000, which was classified as current on the balance sheet.

The Company evaluates its estimates for warranty reserves on an ongoing basis and believes it has the ability to reasonably estimate warranty costs. However, unforeseeable changes in factors may impact the estimate for warranty and such changes could cause a material change in the Company s warranty reserve accrual in the period in which the change was identified.

The changes in the Company s accrued warranty reserve during the three months ended June 30, 2008 includes a provision for warranty costs and replacement costs for reagent discs. The change in the Company s accrued warranty reserve during the three months ended June 30, 2008 and 2007 is summarized as follows (in thousands):

	Three Months Ended June 30,	
	2008	2007
Balance at beginning of period	$ 1,948	$ 847
Provision for warranty expense	507	262
Warranty costs incurred	(340)	(199)
Balance at end of period	2,115	910
Non-current portion of warranty reserve	1,007	295

Current portion of warranty reserve	$ 1,108	$ 615

NOTE 7. LINE OF CREDIT

The Company has a line of credit with Comerica Bank-California which provides for borrowings of up to $2.0 million. 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 4.75% at June 30, 2008, and is payable monthly. At June 30, 2008, of the $2.0 million available, $97,000 was committed to secure a letter of credit for the Company s facilities lease. At June 30, 2008, 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 June 30, 2008 and 2007 were 4.83% and 8.00%, respectively.

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The line of credit agreement contains certain financial covenants, which are evaluated on a quarterly basis. At June 30, 2008, the Company was in compliance with each of these covenants. Included in these financial covenants, among other stipulations, are the following requirements:

The Company must have a minimum net income of $25,000 before preferred stock dividends and accretion on preferred stock 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 required to be profitable, as defined, on a fiscal year to date basis beginning with the six month period ending September 30, 2008 and to have net income before preferred stock dividends and accretion on preferred stock of at least $1.2 million for the fiscal year ending March 31, 2009.

The Company is required to comply with certain financial covenants as follows:

Financial Covenants	Requirements
Quick ratio, as defined	Not less than 2.00 to 1.00
Cash flow coverage, as defined	Not less than 1.25 to 1.00
Debt to net worth ratio, as defined	Not greater than 1.00 to 1.00
Tangible effective net worth, as defined	Not less than $25.7 million

Borrowings under the line of credit are collateralized by the Company s net book value of assets of $109.7 million at June 30, 2008, including its intellectual property.

NOTE 8. COMMITMENTS AND CONTINGENCIES

Purchase Commitments. 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 Medical Instruments PLC. Under the terms of the OEM agreement, the Company became committed to purchase a minimum number of hematology instruments through fiscal 2009 from Diatron once the product was qualified for sale, which occurred in May 2004. In September 2006, the terms of the OEM agreement, with respect to the purchase commitments, were revised and the Company completed its purchase commitments in the quarter ended December 31, 2007. In February 2008, the terms of the OEM agreement, with respect to the purchase commitments, were again revised. Under the amended OEM agreement currently in effect, the Company is committed to purchase a minimum number of hematology instruments through fiscal 2009. At June 30, 2008, the outstanding commitment due in fiscal 2009 is approximately $5.5 million. The commitment amount is based on the minimum number of hematology instruments required to be purchased by the Company, the cost of the instruments and the Euro exchange rate at period-end. Since the exchange rate can fluctuate in the future, the commitment in absolute dollars will change accordingly.

Litigation. 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 9. SHARE-BASED COMPENSATION

Effective April 1, 2006, the Company adopted SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)) using the modified prospective method. 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 the Company s 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, Accounting for Stock-Based Compensation.

Share-based compensation has been classified in the income statement or capitalized on the balance sheet in the same manner as cash compensation paid to employees. Non-cash compensation expense recognized for share-based awards during the three months ended June 30, 2008 and 2007 was $401,000 and $257,000, respectively. Capitalized share-based compensation cost at June 30, 2008 and 2007 was $21,000 and $20,000, respectively, which was included

in inventory on the balance sheet.

Cash Flow Impact

SFAS No. 123(R) requires cash flows resulting from excess tax benefits to be classified as a part of cash flows from financing activities. Excess tax benefits are realized tax benefits from tax deductions for exercised stock options and vested restricted stock units in excess of the deferred tax asset attributable to share-based compensation expense for such share-based awards. Excess tax benefits classified as a financing cash inflow for the three months ended June 30, 2008 and 2007 were $1.8 million and $119,000, respectively.

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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, restricted stock awards, restricted stock units, performance shares, performance units, deferred compensation awards or other share-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 253,000 shares of common stock were available for future issuance as of June 30, 2008.

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 9 for additional information.

Restricted stock units awarded to employees generally vest over a period of four years and the awards may also be 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 generally vest in full one year after the grant date based on continuous service. See the Restricted Stock Units section in this Note 9 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 non-employee 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 June 30, 2008, all outstanding options under the Directors Plan were fully vested and fully exercisable and no shares of common stock were available for future issuance because the time period for granting options expired in accordance with the terms of the Directors Plan in June 2002.

The Company s current practice is to issue new shares of common stock from its authorized shares for share-based awards upon the exercise of stock options or vesting of restricted stock units.

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 with the Company. In addition, prior to April 1, 2006, the Company granted stock options to non-employee directors with an exercise price equal to the closing market price of the Company s common stock on the date of grant and became exercisable over a period of one year based on monthly vesting terms, conditional on continuous service to the Company. There were no stock options granted during fiscal 2007 or 2008 or during the quarter ended June 30, 2008.

The Company used the Black-Scholes option pricing model to determine the fair value of stock options granted prior to March 31, 2006. 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. As of June 30, 2008, the total unrecognized compensation expense related to stock options granted amounted to $30,000, which is expected to be recognized over a weighted average period of 0.33 years.

Stock Option Activity

The following table summarizes information regarding options outstanding and options exercisable at June 30, 2008 and the changes during the three-month period then ended:

	Weighted Average Exercise	Weighted Average Remaining	Aggregate Intrinsic

	Number of Shares	Price Per Share	Contractual Life (Years)	Value (In thousands)
Outstanding at March 31, 2008	1,044,000	$ 7.82		
Granted				
Exercised	(35,000)	6.18		
Canceled or forfeited	(1,000)	12.99		
Outstanding at June 30, 2008	1,008,000	$ 7.87	3.52	$ 16,384
Vested and expected to vest at June 30, 2008	1,007,000	$ 7.87	3.52	$ 16,371
Exercisable at June 30, 2008	997,000	$ 7.83	3.49	$ 16,243

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The aggregate intrinsic value in the table above represents the pre-tax intrinsic value, based on the Company s closing stock price as of June 30, 2008, that would have been received by the option holders had all option holders exercised their stock options as of that date. Total intrinsic value of stock options exercised during the three months ended June 30, 2008 and 2007 was $818,000 and $3.4 million, respectively. Cash proceeds from stock options exercised during the three months ended June 30, 2008 and 2007 were $218,000 and $1.4 million, respectively.

Restricted Stock Units

The Company grants restricted stock unit awards to employees and directors as part of its share-based compensation program which began 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 continuous 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 time-based vesting schedules:

Restricted stock unit awards to employees: Four year time-based vesting as follows: five percent vesting after the 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 of continuous employment with the Company.

Restricted stock unit awards to non-employee directors: 100 percent vesting after one year of continuous service to the Company.

Certain restricted stock unit awards to employees in fiscal 2007 may also be subject to accelerated vesting upon achieving certain performance-based milestones. Additionally, the Compensation Committee of the Company s Board of Directors (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. The Company s Board of Directors has adopted an executive change in control severance plan, which it may terminate or amend at any time, that provides 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 also accelerate in full upon a change in control.

The fair value of restricted stock unit awards used in the Company s expense recognition method is measured based on the number of shares granted and the closing market price of the Company s common stock on the date of grant. Such value is recognized as an expense over the corresponding requisite service period. The Company s policy is to recognize the expense based on the vested portions of the awards. 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 June 30, 2008, the total unrecognized compensation expense related to restricted stock unit awards granted amounted to $13.2 million, which is expected to be recognized over a weighted average period of 2.80 years.

Restricted Stock Unit Activity

The following table summarizes restricted stock unit activity for the three months ended June 30, 2008:

	Number of Shares	Weighted Average Grant Date Fair Value(1)
Unvested at March 31, 2008	494,000	$ 23.21
Granted	197,000	25.00
Vested	(36,000)	23.55
Canceled or forfeited	(7,000)	19.97
Unvested at June 30, 2008	648,000	$ 23.77

(1) The weighted average grant date fair value of restricted stock units is based on the number of shares and the closing market price of the Company s common stock on the date of grant.

Total intrinsic value of restricted stock units vested during the three months ended June 30, 2008 and 2007 was $913,000 and $411,000, respectively. The total grant date fair value of restricted stock units vested during the three months ended June 30, 2008 and 2007 was $860,000 and $464,000, respectively.

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NOTE 10. 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 using the treasury stock method. Dilutive potential common shares outstanding include outstanding stock options, restricted stock units and warrants.

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

		Three Months Ended June 30,	
		2008	2007
Numerator:			
Net income		$ 2,776	$ 3,098
Denominator:			
Weighted average common shares outstanding	basic	21,735,000	21,311,000
Weighted average effect of dilutive securities:			
Stock options		585,000	764,000
Restricted stock units		78,000	15,000
Warrants			12,000
Weighted average common shares outstanding	diluted	22,398,000	22,102,000
Net income per share:			
Basic net income per share		$ 0.13	$ 0.15
Diluted net income per share		$ 0.12	$ 0.14

Stock options and warrants are excluded 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 during the period because the inclusion of these stock options and warrants would be antidilutive to net income per share. During the three months ended June 30, 2008 and 2007, there were no stock options or warrants excluded from the computation of diluted weighted average shares outstanding.

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 June 30,	
	2008	2007
Weighted average number of shares underlying antidilutive restricted stock units	24,000	202,000

NOTE 11. INCOME TAXES

During the three months ended June 30, 2008 and 2007, the Company s effective tax rate was 38%. During the three months ended June 30, 2008, the effective tax rate included a tax benefit for federal qualified production activities and excluded a tax benefit for federal research and development tax credit as a result of the expiration of the credit effective for qualifying research and development expenses incurred after December 31, 2007. The Company s effective tax rates in both the three months ended June 30, 2008 and 2007 includes a reduction related to tax benefits

from tax-exempt investments.

The Company did not have any unrecognized tax benefits as of June 30, 2008 or June 30, 2007. During the three months ended June 30, 2008 and 2007, the Company did not recognize any interest and penalties related to unrecognized tax benefits.

NOTE 12. COMPREHENSIVE INCOME

The following is a summary of comprehensive income for the three months ended June 30, 2008 and 2007 (in thousands):

	Three Months Ended June 30,	
	2008	**2007**
Net income	$ 2,776	$ 3,098
Other comprehensive income:		
Change in unrealized gain (loss) on investments, net of tax	83	
Comprehensive income	$ 2,859	$ 3,098

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NOTE 13. SEGMENT REPORTING INFORMATION

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the Company s chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance.

The Company develops, manufactures, markets and sells portable blood analysis systems for use in the human or veterinary patient-care setting to provide clinicians with rapid blood constituent measurements. The Company identifies its reportable segments as those customer groups that represent more than 10% of the combined revenue or gross profit or loss of all reported operating segments. The Company manages its business on the basis of the following two reportable segments: (i) the medical market and (ii) the veterinary market, which are based on the products sold by market and customer group. Each reportable segment has similar manufacturing processes, technology and shared infrastructures. The accounting policies for segment reporting are the same as for the Company as a whole. Assets are not segregated by segments since the Company s chief operating decision maker does not use assets as a basis to evaluate a particular segment s performance.

Medical Market

In the medical market reportable segment, the Company serves a worldwide customer group consisting of military installations (ships, field hospitals and mobile care units), physicians office practices across all specialties, urgent care and walk-in clinics (free-standing or hospital-connected), home care providers (national, regional or local), nursing homes, ambulance companies, oncology treatment clinics, hospital labs and draw stations. The products manufactured and sold in this segment primarily consist of Piccolo chemistry analyzers and medical reagent discs.

Veterinary Market

In the veterinary market reportable segment, the Company serves a worldwide customer group consisting of companion animal hospitals, animal clinics with mixed practices of small animals, birds and reptiles, equine and bovine practitioners, veterinary emergency clinics, veterinary referral hospitals, universities, government, pharmaceutical companies, biotechnology companies and private research laboratories. The products manufactured and sold in this segment primarily consist of VetScan chemistry analyzers and veterinary reagent discs. The Company also sells OEM-supplied products in this segment, consisting primarily of hematology analyzers and hematology reagent kits.

The table below summarizes revenues, cost of revenues and gross profit from the Company s two operating segments and from certain unallocated items for the three months ended June 30, 2008 and 2007 (in thousands):

	Three Months Ended June 30,	
	2008	2007
Revenues:		
Medical Market	$ 6,529	$ 4,807
Veterinary Market	16,613	16,436
Other(1)	1,430	1,688
Total revenues	24,572	22,931
Cost of revenues:		
Medical Market	3,033	2,443
Veterinary Market	6,827	6,959
Other(1)	1,209	513
Total cost of revenues	11,069	9,915
Gross profit:		
Medical Market	3,496	2,364

Veterinary Market	9,786	9,477
Other(1)	221	1,175
Gross profit	$ 13,503	$ 13,016

(1) Represents unallocated items, not specifically identified to any particular business segment.

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NOTE 14. REVENUES BY PRODUCT CATEGORY AND GEOGRAPHIC REGION AND SIGNIFICANT CONCENTRATIONS

Revenue Information

The following is a summary of revenues for each group of products provided by the Company (in thousands):

	Three Months Ended June 30,	
Revenues by Product Category	**2008**	**2007**
Instruments	$ 7,802	$ 6,464
Reagent discs and kits	14,893	14,259
Other products	1,110	1,737
Product sales, net	23,805	22,460
Development and licensing revenue	767	471
Total revenues	$ 24,572	$ 22,931

The following is a summary of revenues by geographic region based on customer location (in thousands):

	Three Months Ended June 30,	
Revenues by Geographic Region	**2008**	**2007**
North America	$ 20,295	$ 19,169
Europe	3,385	3,057
Asia Pacific and rest of the world	892	705
Total revenues	$ 24,572	$ 22,931

Significant Concentrations

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

		Three Months Ended June 30,	
Distributor	**Geographical Location**	**2008**	**2007**
Walco International, Inc., d/b/a DVM Resources	United States	<10%	15%

During the three months ended June 30, 2008, there were no distributors or direct customers that accounted for more than 10% of total worldwide revenues.

At June 30, 2008, one distributor in the United States accounted for 15% of the Company s trade receivables. At June 30, 2007, one distributor in the United States accounted for 16% of the Company s trade receivables.

NOTE 15. SUBSEQUENT EVENTS

On July 1, 2008, Abaxis sales office in Darmstadt, Germany was incorporated as Abaxis Europe GmbH to market, promote and distribute diagnostic systems for medical and veterinary uses. As a result, Abaxis Europe GmbH became a wholly owned subsidiary of the Company. The subsidiary was formed to provide customer support in response to the growing and increasingly diverse services needs of customers in the Europe market in a timely manner.

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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, intends, plans, future, project, would, may, could, should, might, 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 Part I, Item 1A of our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission (the SEC), that could cause actual results to differ materially from historical results or those anticipated. Such risks and uncertainties include, but are not limited to, the market acceptance of our products and the continuing development of our products, required United States Food and Drug Administration (FDA) 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 associated with liquidity concerns related to our auction rate securities, risks related to the protection of 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) was incorporated in California in 1989. Our principal offices are located at 3240 Whipple Road, Union City, California 94587. Our telephone number is (510) 675-6500 and 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 SEC. Our common stock trades on the NASDAQ Global Market under the symbol ABAX.

We develop, manufacture, market and sell portable blood analysis systems for use in the human or veterinary patient-care setting to provide clinicians with rapid blood constituent measurements. 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 14 tests on human patients and 13 tests on veterinary patients. We manufacture the system in our manufacturing facilities in Union City, California and we market our blood chemistry analyzers in both the medical market and in the veterinary market, as described below.

Medical Market: We currently market the blood analysis system in the medical market under the name Piccolo xpress. Through October 2006, we marketed the blood analysis system in the medical market as the Piccolo®, now referred to as the Piccolo Classic. We continue to support and service our current population of Piccolo xpress and Piccolo Classic chemistry analyzers.

Veterinary Market: We currently market the blood analysis system in the veterinary market under the name VetScan VS2®. 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 VS2 and VetScan Classic chemistry analyzers.

In September 2007, we introduced a veterinary hematology instrument under the name VetScan HM5 . The VetScan HM5 offers a 22-parameter complete blood count (CBC) analysis, including a five-part differential cell counter specifically designed for veterinary applications. In May 2004, we introduced a veterinary hematology instrument that offers an 18-parameter CBC analysis, including a three-part white blood cell differential, marketed originally as the VetScan HMII, and is now referred to as the VetScan HM2 . We currently purchase the hematology instruments from Diatron Medical Instruments PLC. of Budapest, Hungary. Through April 2004, we marketed a veterinary hematology instrument under the name VetScan HMT. We continue to support and service our current population of VetScan HM5, VetScan HM2, VetScan HMII and VetScan HMT hematology instruments. We also market reagent kits to be

used with our hematology instruments which we currently purchase from three suppliers: Clinical Diagnostic Solutions, Inc., Diatron and Mallinckrodt Baker BV.

Our sales for any future periods are not predictable with a significant degree of certainty, and may depend on a number of factors outside of our control, including but not limited to inventory or timing considerations by our distributors. We generally operate with a limited order backlog because our products are typically shipped shortly after orders are received. As a result, product sales in any quarter are generally dependent on orders booked and shipped in that quarter. Our expense levels, which are to a large extent fixed, are based in part on our expectations of future revenues. Accordingly, we may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shortfall. As a result, any such shortfall would negatively affect our operating results and financial condition. In addition, our sales may be adversely impacted by pricing pressure from competitors. Our ability to be consistently profitable will depend, in part, on our ability to increase the sales volumes of our Piccolo and VetScan products and to successfully compete with other competitors. We believe that period to period comparisons of our results of operations are not necessarily meaningful indicators of future results.

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CRITICAL ACCOUNTING POLICIES, ESTIMATES AND JUDGMENTS

Our financial statements are prepared in accordance with 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. Accordingly, 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, 2008.

Revenue Recognition and Deferred Revenue. Our primary customers are distributors and direct customers in both the medical and veterinary markets. Revenues from product sales, net of estimated sales allowances and rebates, are recognized when (i) evidence of an arrangement exists, (ii) upon shipment of the products to the customer, (iii) the sales price is fixed or 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 non-current 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. Revenues from such sales is allocated separately to the instruments and incentives based on the relative fair value of each element. Revenues allocated to incentives is deferred until the goods are shipped to the customer or is recognized ratably over the life of the maintenance contract.

We periodically offer trade-in programs to customers for trading in an existing instrument to purchase a new instrument and we will either provide incentives in the form of free goods 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 incentives from time to time. The distributor pricing rebates are offered to distributors upon meeting the sales volume requirements during a qualifying period. The distributor pricing rebates are recorded as a reduction to gross revenues during the qualifying period. Cash rebates are offered to customers who purchase specific instruments during a promotional period. Cash rebates are recorded as a reduction to gross revenues.

Sales and Other Allowances. We estimate a provision for defective reagent discs as part of sales allowances when we issue credits 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 estimates derived from historical experience. The provision for potentially defective reagent discs was recorded in sales allowances, 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 rates of defective reagent discs. Starting on July 1, 2007, the provision for potentially defective reagent discs is recorded as part of warranty reserves, instead of sales allowances, since we replace defective reagent discs rather than issue a credit to customers. Changes in our estimates for accruals related to provisions for defective reagent discs have not been material to our financial position or results of operations. In the future, the actual defective reagent discs may exceed our estimates, which could adversely affect our financial results.

Allowance for Doubtful Accounts. We maintain an allowance for doubtful accounts based on our assessment of the collectibility of the 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.

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Fair Value of Investments. Various assumptions are used in the valuation models to estimate the fair value of our investments in auction rate securities, including a security s expected future cash flows, market rate of return and term. These assumptions, assessments and the interpretations of relevant market data are subject to uncertainties, are difficult to predict and require significant judgment. The use of different assumptions, applying different judgment to inherently subjective matters and changes in future market conditions could result in significantly different estimates of fair value.

Warranty Reserves. We provide for the estimated future costs to be incurred under our standard warranty obligation on our instruments. Our standard warranty obligation on instruments is two years. The estimated contractual warranty obligation is recorded when the related revenue is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated. While we engage in product quality programs and processes, including monitoring and evaluating the quality of our suppliers, our estimated accrual for warranty exposure is based on historical experience, estimated product failure rates, material usage and freight incurred in repairing the instrument after failure and known design changes.

A provision for defective reagent discs is recorded when related sales are recognized and any additional amounts are recorded when such costs are probable and can be reasonably estimated, at which time they are included in cost of revenues. Prior to July 1, 2007, we primarily issued a credit to customers for defective reagent discs and, therefore, the provision for estimated costs for defective reagent discs, which includes the replacement costs and freight of a defective reagent disc, was recorded as part of sales and other allowances. Starting on July 1, 2007, the provision for defective reagent discs is recorded as part of warranty reserves, since we replace defective reagent discs rather than issue a credit to customers.

We analyze the adequacy of the ending accrual balance of warranty reserves each quarter. The determination of warranty reserves requires us to make estimates of the expected costs to repair or replace the instruments and to replace defective reagent discs under warranty. If actual repair or replacement costs of instruments or replacement costs of reagent discs 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.

Long-Lived Assets. The carrying value of our long-lived assets is reviewed for impairment, in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, whenever events or changes in circumstances indicate that the carrying amount of 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 SFAS 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. Effective April 1, 2006, we adopted SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)) using the modified prospective method. 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.

We use the Black-Scholes option pricing model to determine the fair value of stock options granted prior to March 31, 2006. Determining the appropriate fair value model and calculating the fair value of share-based awards requires highly subjective assumptions, as described below.

Risk-free interest rate: The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant for the expected term of the option.

Expected stock price volatility: We estimate the volatility of our common stock at the date of grant based on the historical volatility of our common stock.

Expected term: We estimate the expected term of stock options granted based on historical exercise and post-vesting termination patterns, which we believe are representative of future behavior.

Expected dividends: We have not paid cash dividends on our common stock and we do not anticipate paying cash dividends in the foreseeable future; consequently, we use an expected dividend yield of zero.

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For restricted stock units, the assumptions to calculate compensation expense is based on the fair value of our stock at the grant date. As a result, if factors change and we use different assumptions, our share-based compensation expense could be materially different in the future.

As required by SFAS No. 123(R), employee share-based compensation expense recognized is calculated based on the awards expected to vest and reduced for estimated forfeitures. The forfeiture rate is estimated based on historical data of our share-based awards that are granted and cancelled prior to vesting 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 compensation expense could be materially impacted in the quarter of revision, as well as in following quarters.

RESULTS OF OPERATIONS

We develop, manufacture, market and sell portable blood analysis systems for use in the human or veterinary patient-care setting to provide clinicians with rapid blood constituent measurements. We operate in two segments: (i) the medical market and (ii) the veterinary market. See Segment Results in this section for a detailed discussion.

Total Revenues

Revenues by Geographic Region and by Product Category. Revenues by geographic region based on customer location and revenues by product category during the three months ended June 30, 2008 and 2007 were as follows (in thousands, except percentages):

	Three Months Ended June 30,		Change	
Revenues by Geographic Region	**2008**	**2007**	**Increase/ (Decrease)**	**Percent Change**
North America	$ 20,295	$ 19,169	$ 1,126	6%
Percentage of total revenues	83%	84%		
Europe	3,385	3,057	328	11%
Percentage of total revenues	14%	13%		
Asia Pacific and rest of the world	892	705	187	27%
Percentage of total revenues	3%	3%		
Total revenues	$ 24,572	$ 22,931	$ 1,641	7%

	Three Months Ended June 30,		Change	
Revenues by Product Category	**2008**	**2007**	**Increase/ (Decrease)**	**Percent Change**
Instruments	$ 7,802	$ 6,464	$ 1,338	21%
Percentage of total revenues	32%	28%		
Reagent discs and kits	14,893	14,259	634	4%
Percentage of total revenues	61%	62%		
Other products	1,110	1,737	(627)	(36%)
Percentage of total revenues	4%	8%		
Product sales, net	23,805	22,460	1,345	6%
Percentage of total revenues	97%	98%		
Development and licensing revenue	767	471	296	63%
Percentage of total revenues	3%	2%		
Total revenues	$ 24,572	$ 22,931	$ 1,641	7%

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Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007

North America. During the three months ended June 30, 2008, total revenues in North America increased 6%, or $1.1 million, as compared to the three months ended June 30, 2007. Components of the change in North America were as follows:

Instruments. During the three months ended June 30, 2008, total revenues from instruments sold in North America increased 27%, or $1.3 million, as compared to the three months ended June 30, 2007. The primary factors of the change were as follows:

(i) Sales of our Piccolo chemistry analyzers to the U.S. government increased 1176%, or $694,000, primarily due to an increase in the U.S. Military s needs for our products, which were not predictable. Sales of our Piccolo chemistry analyzers in North America (excluding the U.S. government) decreased 9%, or $150,000.

(ii) Sales of our VetScan chemistry analyzers in North America increased 42%, or $710,000, primarily due to quality improvements on our analyzers.

(iii) Sales of our hematology instruments in North America increased 4%, or $67,000.

Reagent discs and kits. During the three months ended June 30, 2008, total revenues from reagent discs and kits sold in North America increased 1%, or $100,000, as compared to the three months ended June 30, 2007. The primary factors of the change were as follows:

(i) Medical reagent discs sales in North America (excluding the U.S. government) increased 51%, or $894,000, primarily due to the expanded installed base of our Piccolo chemistry analyzers. Medical reagent discs sold to the U.S. government increased 28%, or $132,000.

(ii) Veterinary reagent discs sales in North America decreased 11%, or $969,000, primarily due to decreased demand as a result of inventory balancing by our distributors.

(iii) Sales of our hematology reagent kits in North America increased 6%, or $43,000.

Other products. During the three months ended June 30, 2008, total revenues from other products sold in North America decreased 35%, or $591,000, as compared to the three months ended June 30, 2007. The net decrease in other products was primarily due to an increase in maintenance contracts offered to customers from time to time as incentives in the form of free goods in connection with the sale of our products.

Development and licensing. During the three months ended June 30, 2008, total revenues from development and licensing in North America increased 63%, or $296,000, as compared to the three months ended June 30, 2007. The increase from development and licensing revenue is primarily due to a licensing agreement with Cepheid, related to our proprietary technology, the Orbos® Discrete Lyophilization Process.

Significant concentration. There were no distributors or direct customers that accounted for more than 10% of our total worldwide revenues for the three months ended June 30, 2008. One distributor in the United States, DVM Resources, accounted for 15% of our total worldwide revenues for the three months ended June 30, 2007.

Europe. During the three months ended June 30, 2008, total revenues in Europe increased 11%, or $328,000, as compared to the three months ended June 30, 2007. Components of the change in Europe were as follows:

Instruments. During the three months ended June 30, 2008, total revenues from instruments sold in Europe decreased 10%, or $135,000, as compared to the three months ended June 30, 2007. The primary factors of the change were as follows:

(i) Sales of our Piccolo chemistry analyzers in Europe increased 6%, or $15,000.

(ii) Sales of our VetScan chemistry analyzers in Europe decreased 17%, or $164,000.

(iii) Sales of our hematology instruments in Europe increased 14%, or $14,000.

Reagent discs and kits. During the three months ended June 30, 2008, total revenues from reagent discs and kits sold in Europe increased 29%, or $496,000, as compared to the three months ended June 30, 2007. The primary factors of the change were as follows:

(i) Medical reagent discs sales in Europe increased 79%, or $173,000.

(ii) Veterinary reagent discs sales in Europe increased 23%, or $322,000, primarily due to the expanded installed base of our VetScan chemistry analyzers.

(iii) Sales of our hematology reagent kits in Europe were substantially the same as in the three months ended June 30, 2007.

Other products. During the three months ended June 30, 2008, total revenues from other products sold in Europe decreased 70%, or $33,000, as compared to the three months ended June 30, 2007.

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Asia Pacific and rest of the world. During the three months ended June 30, 2008, total revenues in Asia Pacific and rest of the world increased 27%, or $187,000, as compared to the three months ended June 30, 2007. Components of the change in Asia Pacific and rest of the world were as follows:

Instruments. During the three months ended June 30, 2008, total revenues from instruments sold in Asia Pacific and rest of the world increased 82%, or $152,000, as compared to the three months ended June 30, 2007. The primary factors of the change were as follows:

(i) Sales of our Piccolo chemistry analyzers in Asia Pacific and rest of the world increased 32%, or $14,000.

(ii) Sales of our VetScan chemistry analyzers in Asia Pacific and rest of the world increased 128%, or $97,000.

(iii) Sales of our hematology instruments in Asia Pacific and rest of the world increased 63%, or $41,000.

Reagent discs and kits. During the three months ended June 30, 2008, total revenues from reagent discs and kits sold in Asia Pacific and rest of the world increased 7%, or $38,000, as compared to the three months ended June 30, 2007. The primary factors of the change were as follows:

(i) Medical reagent discs sales in Asia Pacific and rest of the world decreased 31%, or $16,000.

(ii) Veterinary reagent discs sales in Asia Pacific and rest of the world increased 9%, or $38,000.

(iii) Sales of our hematology reagent kits in Asia Pacific and rest of the world increased 57%, or $16,000.

Other products. During the three months ended June 30, 2008, total revenues from other products sold in Asia Pacific and rest of the world were substantially the same as in the three months ended June 30, 2007.

Segment Results

Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007

The following table presents revenues, cost of revenues, gross profit and percent of revenues by operating segments for the three months ended June 30, 2008 and 2007 (in thousands, except percentages):

	Three Months Ended June 30,				Change	
	2008	Percent of Revenues(1)	2007	Percent of Revenues(1)	Increase/ (Decrease)	Percent Change
Revenues:						
Medical Market	$ 6,529	100%	$ 4,807	100%	$ 1,722	36%
Percentage of total revenues	26%		21%			
Veterinary Market	16,613	100%	16,436	100%	177	1%
Percentage of total revenues	68%		72%			
Other(2)	1,430		1,688		(258)	(15%)
Percentage of total revenues	6%		7%			
Total revenues	24,572		22,931		1,641	7%
Cost of revenues:						
Medical Market	3,033	46%	2,443	51%	590	24%
Veterinary Market	6,827	41%	6,959	42%	(132)	(2%)
Other(2)	1,209		513		696	136%
Total cost of revenues	11,069		9,915		1,154	12%
Gross profit:						
Medical Market	3,496	54%	2,364	49%	1,132	48%
Veterinary Market	9,786	59%	9,477	58%	309	3%

Other(2)	221	1,175	(954)	(81%)
Gross profit	$ 13,503	$ 13,016	$ 487	4%

(1) The percentages reported are based on revenues by operating segment.

(2) Represents unallocated items, not specifically identified to any particular business segment.

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Medical Market

Revenues for Medical Market Segment

During the three months ended June 30, 2008, total revenues in the medical market increased 36%, or $1.7 million, as compared to the three months ended June 30, 2007. Components of the change were as follows:

Instruments. Total revenues from sales of our Piccolo chemistry analyzers increased 28%, or $573,000, during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007. We sold a total of 208 Piccolo chemistry analyzers during the three months ended June 30, 2008, as compared to 177 Piccolo chemistry analyzers sold during the three months ended June 30, 2007. The changes in revenues were attributed to (a) an increase in Piccolo chemistry analyzers sold to the U.S. government of 1176%, or $694,000, primarily due to an increase in the U.S. Military s needs for our products, which were not predictable; (b) an increase in revenues in Europe of 6%, or $15,000; and (c) an increase in revenues in Asia Pacific and rest of the world of 32%, or $14,000. The increase was partially offset by a decrease in revenues in North America (excluding the U.S. government) of 9%, or $150,000.

Reagent discs. Total revenues from reagent discs sold in the medical market increased 48%, or $1.2 million, during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007. We sold 404,000 medical reagent discs during the three months ended June 30, 2008, as compared to 274,000 medical reagent discs sold during the three months ended June 30, 2007. The total increase in revenues from medical reagent discs was primarily attributed to the expanded installed base of our Piccolo chemistry analyzers and consisted of (a) an increase in revenues in North America (excluding the U.S. government) of 51%, or $894,000; (b) an increase in medical reagent discs sold to the U.S. government of 28%, or $132,000; and (c) an increase in revenues in Europe of 79%, or $173,000. The increase was partially offset by a decrease in revenues in Asia Pacific and rest of the world of 31%, or $16,000.

Gross Profit for Medical Market Segment

Gross profit for the medical market segment increased 48%, or $1.1 million, during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007. Gross profit percentages for the medical market segment during the three months ended June 30, 2008 and 2007 were 54% and 49%, respectively. In absolute dollars, the increase in gross profit for the medical market segment was due to (a) an increase in Piccolo chemistry analyzers and medical reagent discs sold during the three months ended June 30, 2008 and (b) higher average selling prices of Piccolo chemistry analyzers and medical reagent discs sold during the three months ended June 30, 2008.

Veterinary Market

Revenues for Veterinary Market Segment

During the three months ended June 30, 2008, total revenues in the veterinary market increased 1%, or $177,000, as compared to the three months ended June 30, 2007. Components of the change were as follows:

Instruments. Total revenues from our veterinary instruments sold increased 17%, or $765,000, during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007. We sold a total of 596 VetScan chemistry analyzers and hematology instruments during the three months ended June 30, 2008, as compared to an aggregate of 500 veterinary instruments sold during the three months ended June 30, 2007. The primary factors of the change were as follows:

(i) Sales of our VetScan chemistry analyzers increased 24%, or $643,000, comprised of (a) an increase in revenues in North America of 42%, or $710,000, primarily due to quality improvements on our analyzers; and (b) an increase in revenues in Asia Pacific and rest of the world of 128%, or $97,000. The increase was partially offset by a decrease in revenues in Europe of 17%, or $164,000.

(ii) Sales of our hematology instruments increased 7%, or $122,000, comprised of (a) an increase in revenues in North America of 4%, or $67,000; (b) an increase in revenues in Europe of 14%, or $14,000; and (c) an increase in revenues in Asia Pacific and rest of the world of 63%, or $41,000.

Reagent discs and kits. Total revenues from reagent discs and hematology reagent kits sold in the veterinary market decreased 5%, or $549,000, during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007. The primary factors of the change were as follows:

(i) Total revenues from reagent discs sold in the veterinary market decreased 6%, or $609,000, during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007. We sold 775,000 veterinary reagent discs during the three months ended June 30, 2008, as compared to 864,000 veterinary reagent discs sold during the three months ended June 30, 2007. The decrease in revenues from veterinary reagent discs was attributed to a decrease in revenues in North America of 11%, or $969,000, primarily due to decreased demand as a result of inventory balancing by our distributors. The decrease was partially offset by (a) an increase in revenues in Europe of 23%, or $322,000, primarily due to the expanded installed base of our VetScan chemistry analyzers and (b) an increase in revenues in Asia Pacific and rest of the world of 9%, or $38,000.

(ii) Total revenues from hematology reagent kits sold increased 7%, or $60,000, during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007. The increase in revenues from hematology reagent kits was attributed to (a) an increase in revenues in North America of 6%, or $43,000 and (b) an increase in revenues in Asia Pacific and rest of the world of 57%, or $16,000. Hematology reagent kits in Europe were substantially the same as in the three months ended June 30, 2007.

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Gross Profit for Veterinary Market Segment

Gross profit for the veterinary market segment increased 3%, or $309,000, during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007. Gross profit percentages for the veterinary market segment during the three months ended June 30, 2008 and 2007 were 59% and 58%, respectively. In absolute dollars, the increase in gross profit for the veterinary market segment was due to an increase in Vetscan chemistry analyzers sold during the three months ended June 30, 2008.

Cost of Revenues

The following sets forth our cost of revenues for the periods indicated (in thousands, except percentages):

	Three Months Ended June 30,		Change	
	2008	2007	Increase/ (Decrease)	Percent Change
Cost of revenues	$ 11,069	$ 9,915	$ 1,154	12%
Percentage of total revenues	45%	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 reagent kits and manufacturing overhead, including costs of personnel and equipment associated with manufacturing support.

Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007

Cost of revenues increased 12%, or $1.2 million, during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007, primarily due to the following: (a) an increase in the sales volume of Piccolo and Vetscan chemistry analyzers and medical reagent discs during the three months ended June 30, 2008 and (b) higher average selling prices of Piccolo chemistry analyzers and medical reagent discs sold during the three months ended June 30, 2008.

Operating Expenses

Research and Development

The following sets forth our research and development expenses for the periods indicated (in thousands, except percentages):

	Three Months Ended June 30,		Change	
	2008	2007	Increase/ (Decrease)	Percent Change
Research and development expenses	$ 1,997	$ 1,653	$ 344	21%
Percentage of total revenues	8%	7%		

Research and development expenses consist of personnel costs (including salaries, benefits and share-based compensation expense), consulting expenses and materials and related expenses associated with the development of new tests and test methods, clinical trials, product improvements and enhancement of existing products.

Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007

Research and development expenses increased 21%, or $344,000, during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007, primarily due to new product development and enhancement of existing products and clinical trials. Research and development expenses are based on the project activities planned and the level of spending depend on budgeted expenditures. The projects primarily relate to new product development in both the medical and veterinary markets and costs related to compliance with FDA regulations and clinical trials. Share-based compensation expense during the three months ended June 30, 2008 and 2007, was $61,000 and $35,000, respectively.

We anticipate the dollar amount of research and development expenses to increase in fiscal 2009 from fiscal 2008 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.

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Sales and Marketing

The following sets forth our sales and marketing expenses for the periods indicated (in thousands, except percentages):

	Three Months Ended June 30,		Change	
	2008	2007	Increase/ (Decrease)	Percent Change
Sales and marketing expenses	$ 5,827	$ 5,229	$ 598	11%
Percentage of total revenues	24%	23%		

Sales and marketing expenses consist of personnel costs (including salaries, benefits and share-based compensation expense), 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 Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007

Sales and marketing expenses increased 11%, or $598,000, during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007, primarily due to personnel-related costs resulting from an increase in headcount in various divisions including sales and marketing, customer service and technical service, to support the growth in both our medical and veterinary markets. Share-based compensation expense during the three months ended June 30, 2008 and 2007, was $137,000 and $80,000, respectively.

General and Administrative

The following sets forth our general and administrative expenses for the periods indicated (in thousands, except percentages):

	Three Months Ended June 30,		Change	
	2008	2007	Increase/ (Decrease)	Percent Change
General and administrative expenses	$ 1,662	$ 1,651	$ 11	1%
Percentage of total revenues	7%	7%		

General and administrative expenses consist of personnel costs (including salaries, benefits and share-based compensation expense), and expenses for outside professional services related to general corporate functions, including accounting, human resources and legal.

Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007

General and administrative expenses increased 1%, or $11,000, during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007. Share-based compensation during the three months ended June 30, 2008 and 2007, was $168,000 and $122,000, respectively.

Interest and Other Income (Expense), Net

The following sets forth our interest and other income (expense), net, for the periods indicated (in thousands, except percentages):

	Three Months Ended June 30,		Change	
	2008	2007	Increase/ (Decrease)	Percent Change
Interest and other income (expense), net	$ 462	$ 499	$ (37)	(7)%

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

Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007

Interest and other income (expense), net, decreased 7%, or $37,000, during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007, primarily attributed to lower interest yields in our investment portfolio compared to the same period in fiscal 2008.

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Income Tax Provision

The following sets forth our income tax provision for the periods indicated (in thousands, except percentages):

	Three Months Ended June 30,	
	2008	2007
Income tax provision	$ 1,703	$ 1,884
Effective tax rate	38%	38%

Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007

During the three months ended June 30, 2008 and 2007, our effective tax rate was 38%. During the three months ended June 30, 2008, our effective tax rate included a tax benefit for federal qualified production activities and excluded a tax benefit for federal research and development tax credit as a result of the expiration of the credit effective for qualifying research and development expenses incurred after December 31, 2007. Our effective tax rates in both the three months ended June 30, 2008 and 2007 includes a reduction related to tax benefits from tax-exempt investments.

We did not have any unrecognized tax benefits as of June 30, 2008 or June 30, 2007. During the three months ended June 30, 2008 and 2007, we did not recognize any interest and penalties related to unrecognized tax benefits.

LIQUIDITY AND CAPITAL RESOURCES

Total cash, cash equivalents and short-term and long-term investments at June 30, 2008 and March 31, 2008 were as follows (in thousands, except percentages):

	June 30, 2008	March 31, 2008
Cash and cash equivalents	$ 23,031	$ 17,219
Short-term investments	6,991	6,991
Long-term investments	31,559	35,463
Total cash, cash equivalents and investments	$ 61,581	$ 59,673
Percentage of total assets	50%	49%

Cash Flow Changes

Cash provided by (used in) the three months ended June 30, 2008 and 2007 were as follows (in thousands):

	Three Months Ended June 30,	
	2008	2007
Net cash provided by operating activities	$ 554	$ 3,548
Net cash provided by (used in) investing activities	3,496	(6,008)
Net cash provided by financing activities	1,762	1,436
Net increase (decrease) in cash and cash equivalents	$ 5,812	$ (1,024)

At June 30, 2008, we had net working capital of $61.8 million compared to $52.5 million at March 31, 2008. Cash and cash equivalents at June 30, 2008 were $23.0 million, compared to $17.2 million at March 31, 2008. The increase in cash and cash equivalents was primarily due to proceeds from redemptions of $4.0 million of long-term investments in auction rate securities, partially offset by purchases of property and equipment of $524,000.

Operating Activities

During the three months ended June 30, 2008, we generated $554,000 in cash from operating activities. The cash provided by operating activities during the three months ended June 30, 2008 was primarily the result of net income of $2.8 million, adjusted for the effects of non-cash adjustments including depreciation and amortization of $1.0 million, share-based compensation expense of $401,000 and deferred income taxes of $1.4 million; partially offset by a decrease of $1.8 million related to excess tax benefits from share-based awards.

Other changes in operating activities during the three months ended June 30, 2008 were as follows:

(i) Net trade receivables increased by $79,000, from $20.9 million at March 31, 2008 to $21.0 million as of June 30, 2008.

(ii) Net inventories decreased by $299,000, from $18.7 million at March 31, 2008 to $18.4 million as of June 30, 2008.

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(iii) Prepaid expenses increased by $763,000, from $427,000 at March 31, 2008 to $1.2 million as of June 30, 2008, primarily due to the timing of payments.
(iv) Current net deferred tax asset increased by $334,000, from $2.4 million at March 31, 2008 to $2.8 million as of June 30, 2008, primarily as a result of certain operating expenses recognized in the three months ended June 30, 2008 which are currently non-deductible for tax purposes and an increase in California research and development tax credits carryovers.
(v) Accounts payable decreased by $1.6 million, from $6.4 million at March 31, 2008 to $4.8 million as of June 30, 2008, primarily due to the timing and payment of services and inventory purchases.
(vi) Accrued payroll and related expenses decreased by $830,000, from $4.3 million at March 31, 2008 to $3.4 million as of June 30, 2008, primarily due to the payment of our payroll and management incentive compensation program for fiscal 2008.
(vii) Total deferred revenue increased by $331,000, resulting from an increase in the current portion of deferred revenue of $68,000, from $807,000 at March 31, 2008 to $875,000 as of June 30, 2008, and an increase in the non-current portion of deferred revenue of $263,000, from $1.1 million at March 31, 2008 to $1.4 million as of June 30, 2008, primarily due to an increase in maintenance contracts offered to customers from time to time as incentives in the form of free goods in connection with the sale of our products.
(viii) Total warranty reserves increased by $167,000, resulting from an increase in the non-current portion of warranty reserves of $278,000, from $729,000 at March 31, 2008 to $1.0 million as of June 30, 2008, partially offset by a decrease in the current portion of warranty reserves of $111,000, from $1.2 million at March 31, 2008 to $1.1 million as of June 30, 2008. The net change in warranty reserves is based on (a) the number of instruments in standard warranty and estimated repair costs and (b) an estimate of defective reagent discs and replacement costs.
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.

Investing Activities

Net cash provided by investing activities during the three months ended June 30, 2008 totaled $3.5 million, compared to net cash (used in) investing activities of $6.0 million during the three months ended June 30, 2007. Changes in investing activities were as follows:

Investments. Cash used to purchase certificate of deposits totaled $7.0 million during the three months ended June 30, 2008. Cash provided by proceeds from (a) maturities of certificate of deposits and municipal bonds totaled $7.0 million and (b) redemptions of auction rate securities totaled $4.0 million during the three months ended June 30, 2008.

Property and Equipment. Cash used to purchase property and equipment totaled $524,000 during the three months ended June 30, 2008, primarily to support (a) new product introduction and (b) 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 three months ended June 30, 2008 totaled $1.8 million, primarily consisting of $218,000 from proceeds from stock options exercised and $1.8 million from excess tax benefits from share-based awards, partially offset by the payment of income withholding taxes of $229,000 due upon vesting of restricted stock units.

Line of Credit

We have a line of credit with Comerica Bank-California which provides for borrowings of up to $2.0 million. The line of credit terminates upon notification by either party and any outstanding balance is payable upon demand. The line of credit bears interest at the bank s prime rate minus 0.25%, which totaled 4.75% at June 30, 2008, and is payable monthly. At June 30, 2008, of the $2.0 million available, $97,000 was committed to secure a letter of credit for our facilities lease. At June 30, 2008, 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 June 30, 2008 and 2007 were 4.83% and 8.00%,

respectively.

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The line of credit agreement contains certain financial covenants, which are evaluated on a quarterly basis. At June 30, 2008, we were in compliance with each of these covenants. Included in these financial covenants, among other stipulations, are the following requirements:

We must have a minimum net income of $25,000 before preferred stock dividends and accretion on preferred stock 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 required to be profitable, as defined, on a fiscal year to date basis beginning with the six month period ending September 30, 2008 and to have net income before preferred stock dividends and accretion on preferred stock of at least $1.2 million for the fiscal year ending March 31, 2009.

We are required to comply with certain financial covenants as follows:

Financial Covenants	Requirements
Quick ratio, as defined	Not less than 2.00 to 1.00
Cash flow coverage, as defined	Not less than 1.25 to 1.00
Debt to net worth ratio, as defined	Not greater than 1.00 to 1.00
Tangible effective net worth, as defined	Not less than $25.7 million

Borrowings under the line of credit are collateralized by our net book value of assets of $109.7 million at June 30, 2008, including our intellectual property.

Purchase Commitments

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

Contingencies

We are involved from time to time in various litigation matters in the normal course of business. While the outcome of these proceedings and claims cannot be predicted with certainty, we do not believe that the ultimate resolution of these matters will have a material effect on our financial position or results of operations.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Financial Condition

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 12 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.

RECENT ACCOUNTING PRONOUNCEMENTS

A discussion of recent accounting pronouncements is included in Note 2 of the Notes to the Unaudited Condensed Financial Statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

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

Our investment portfolio is typically comprised of investments in auction rate securities, certificate of deposits, corporate debt securities or municipal bonds.

Our investment objective is to invest excess cash in cash equivalents and in various types of investments to maximize yields without significantly increased risk. At June 30, 2008, our short-term investments totaled $7.0 million, consisting of certificate of deposits. At June 30, 2008, our long-term investments totaled $31.6 million, consisting of auction rate securities. At June 30, 2008, we had unrealized losses, net of related income taxes of $1.3 million, which were temporary and reported as a component of accumulated other comprehensive loss. During the first quarter of fiscal 2008, we redeemed $4.0 million of our auction rate securities at par value.

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Although auction rate securities may have maturities beyond one year, these securities were historically classified as short-term, based on their highly liquid nature and due to the frequency with which the interest rate is reset; accordingly we have had the ability to quickly liquidate these securities in the past. The recent negative conditions in the global credit markets have prevented some investors from liquidating their holdings of auction rate securities because the amount of securities submitted for sale has exceeded the amount of purchase orders for such securities. If the credit market does not improve, auctions for our invested amounts may continue to fail. If an auction fails for securities in which we have invested, we may be unable to liquidate some or all of our auction rate securities at par, should we need or desire to access the funds invested in those securities. In the event we need or desire to access these funds, we will not be able to do so until a future auction on these investments is successful or a buyer is found outside the auction process. If a buyer is found but is unwilling to purchase the investments at par, we may incur a loss. The fair value of our auction rate securities could change significantly based on market conditions and continued uncertainties in the credit markets. If conditions in the credit markets deteriorate further causing additional auctions to fail, the funds associated with these auction rate securities may not be accessible for an undetermined period of time, and we may be required to record losses or an impairment charge on our auction rate securities in future quarters. Based on our ability to access our cash and other short-term investments and our expected operating cash flows, we currently do not anticipate these investments in auction rate securities will affect our ability to execute our current business, operating results or financial condition.

We have the ability to hold the certificate of deposits in our investment portfolio at June 30, 2008 until maturity and therefore, we believe we have no material exposure to interest rate risk. A sensitivity analysis assuming a hypothetical 10% movement in interest rates applied to our total investment balances at June 30, 2008 indicated that such market movement would not have a material effect on our business, operating results or financial condition. We have not experienced any significant losses on our investment portfolio.

For our line of credit, which provides for borrowings of up to $2.0 million, the interest rate is equal to the bank s prime rate minus 0.25%, which totaled 4.75% at June 30, 2008. Consequently, an increase in the prime rate would expose us to higher interest expenses. A sensitivity analysis assuming a hypothetical 10% movement in the prime rate applied to our line of credit balance at June 30, 2008 indicated that such market movement would not have a material effect on our business, operating results or financial condition, as there was no amount outstanding on our line of credit at June 30, 2008.

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.

Foreign Currency Rate Fluctuations

We operate primarily in the United States and a majority of our revenues, cost of revenues, operating expenses and capital purchasing activities for the quarter ended June 30, 2008 were transacted in U.S. dollars. However, we are exposed to foreign currency exchange rate fluctuations on the hematology instruments and hematology reagent kits purchased from Diatron Messtechnik GmbH, which are denominated in Euros. Additionally, operations from our Germany sales office are stated in Euros and translated into U.S. dollars at the period-end exchange rates. Such operations have not been significant to date. To the extent the U.S. dollar strengthens against the Euro currency, the translation of the foreign currency denominated transactions may result in reduced cost of revenues and operating expenses. Similarly, our cost of revenues and operating expenses will increase, if the U.S. dollar weakens against the Euro currency.

There have been no material changes in our market risk during the three months ended June 30, 2008 compared to the disclosures in Part II, Item 7A of our Annual Report on Form 10-K for the fiscal year ended March 31, 2008.

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 (which are defined under Securities and Exchange

Commission rules as controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, (the Exchange Act) is recorded, processed, summarized and reported within required time periods), were effective as of June 30, 2008.

Changes in Internal Control over Financial Reporting

During the quarter ended June 30, 2008, there was 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.

Inherent Limitations on Controls and Procedures

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Accordingly, even an effective system of internal control will provide only reasonable assurance that the objectives of the internal control system are met.

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Item 4T. Controls and Procedures

Not applicable.

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 do not believe that the ultimate resolution of these matters will have a material effect on our financial position or results of operations.

Item 1A. Risk Factors

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, continue, could, estimates, expects, future, may, might, plans, projects, will and similar expressions identify forward-looking statements. Our actual results 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.

In evaluating our business, you should carefully consider the following risks in addition to the other information in our Annual Report on Form 10-K for the fiscal year ended March 31, 2008 as filed with the Securities and Exchange Commission on June 13, 2008. We note these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. It is not possible to predict or identify all such factors and, therefore, you should not consider the following risks to be a complete statement of all the potential risks or uncertainties that we face.

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 medical and veterinary markets is 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 a 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.

The sales cycle for our products can fluctuate, which may cause revenue and operating results to vary significantly from period to period. We believe this fluctuation is due primarily to (i) seasonal patterns in the decision making processes by our independent distributors and direct customers, (ii) inventory or timing considerations by our distributors and (iii) on the purchasing requirements of the U.S. Military to acquire our products. Accordingly, we believe that period to period comparisons of our results of operations are not necessarily meaningful.

In the future, our periodic operating results may vary significantly depending on, but not limited to, a number of factors, including:

- 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;

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our manufacturing capacities and our ability to increase the scale of these capacities;
the mix of product sales between our blood chemistry analyzers and our reagent disc products;
the amount we spend on research and development; and
changes in our strategy.

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

We believe that 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 overall 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.

In the human medical market, we have relatively limited experience in large-scale sales of our Piccolo blood chemistry analyzers. Although we believe that our blood chemistry analyzers offer consumers many advantages, including substantial cost savings according to our analyses, in terms of implementation of the actual product, 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 Piccolo blood chemistry analyzers and our other products, we will suffer lost sales and could fail to achieve anticipated revenue.

Historically, in the veterinary market, we have marketed our VetScan systems through both direct sales and distribution channels to veterinarians. We continue to develop new animal blood tests to expand and we cannot be assured that these tests will be accepted by the veterinary market.

We could fail to achieve anticipated revenue if problems related to the manufacture of our new blood chemistry analyzers are not resolved.

We manufacture our blood chemistry analyzers at our manufacturing facility in Union City, California. We have recently experienced problems related to the manufacture of our new blood chemistry analyzer, which are primarily related to difficulties and delays in obtaining certain key components that we purchase from various suppliers. These manufacturing problems may be potentially related to quality control issues for key components that we obtain from our suppliers or to design issues of the key components required in our blood chemistry analyzer. Our difficulties in obtaining an adequate amount of quality components for the manufacture of our blood chemistry analyzer had a materially adverse impact on our sales of Vetscan chemistry analyzers in fiscal 2008. We have taken, and are continuing to take, steps to resolve these issues, but there can be no assurance that our efforts to resolve these manufacturing difficulties will be successful. If we are unable to resolve these manufacturing problems on our new blood chemistry analyzer, we will not be able to manufacture sufficient quantities to meet anticipated demand and, therefore, will not be able to effectively market and sell our new blood chemistry analyzer; accordingly, our revenue and business would be materially adversely affected.

We have invested a significant portion of our cash in auction rate securities, the market for which is currently illiquid. Funds associated with certain of our auction rate securities may not be accessible for an undetermined period of time and our auction rate securities may experience an other than temporary decline in value, which would adversely affect our statement of operations.

Our investment portfolio includes auction rate securities that are structured with short-term interest rate reset dates of generally less than 30 days, but with contractual maturities that can be well in excess of ten years or may never mature. At the end of each reset period, which occurs ranging from every seven to 28 days, depending on the security, investors can sell or continue to hold the securities at par. This mechanism has historically provided a liquid market for these securities. However, the recent negative conditions in the global credit markets have prevented some investors from liquidating their holdings of auction rate securities because the amount of securities submitted for sale has exceeded the amount of purchase orders for such securities. At June 30, 2008, we held $33.0 million par value of our investments in auction rate securities for which the auctions had been unsuccessful. At June 30, 2008, the fair value of these auction rate securities was $31.6 million. An auction failure, which is not a default in the underlying debt instrument, occurs when there are more sellers than buyers at a scheduled interest rate auction date and parties

desiring to sell their securities are unable to do so. If the credit market does not improve, auctions for our invested amounts may continue to fail. If an auction fails for securities in which we have invested, we may be unable to liquidate some or all of our auction rate securities at par, should we need or desire to access the funds invested in those securities. In the event we need or desire to access these funds, we will not be able to do so until a future auction on these investments is successful or a buyer is found outside the auction process. If a buyer is found but is unwilling to purchase the investments at par, we may incur a loss. Furthermore, if the issuers of the auction rate securities are unable to successfully complete future auctions and their credit ratings deteriorate, we may be required to adjust the carrying value of these investments by recording an impairment charge.

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During the first quarter of fiscal 2009, $4.0 million of our auction rate securities were redeemed at par value. However, there is no assurance that any of the other auction rate securities in our portfolio will be redeemed at par value in the future, or at all. Additionally, there is no assurance as to when the market for auction rate securities will stabilize. The fair value of our auction rate securities could change significantly based on market conditions and continued uncertainties in the credit markets. If conditions in the credit markets deteriorate further causing additional auctions to fail, the funds associated with these auction rate securities may also not be accessible for an undetermined period of time, and we may be required to record losses or an impairment charge on our auction rate securities portfolio in future quarters, which would harm our financial condition.

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

As of June 30, 2008, 37 patent applications have been filed on our behalf with the United States Patent and Trademark Office (USPTO), of which 30 patents have been issued and 29 patents are currently active. 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 us, 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 USPTO 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 USPTO, 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 increase sales of our Piccolo and VetScan products or we may not be able to maintain profitability.

As of June 30, 2008, we had a cumulative net loss of $191,000. Our ability to continue to be 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, among other things, our ability to:

- continue to improve our existing products and develop new and innovative 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 sustain profitability.

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

Although we have gained experience marketing our VetScan products in the veterinary diagnostic market, we have limited sales, marketing and distribution experience with our Piccolo chemistry analyzers 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 sales, marketing and distributing our products will not be excessive.

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Should we fail to effectively develop our sales, 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 occurs in limited quantities, that we have not anticipated or otherwise. Our Piccolo and VetScan chemistry analyzers may be unable to detect all errors which could result in the misdiagnosis of human or veterinary patients.

Should we inadvertently manufacture and ship defective products, we may be subject to substantial claims under our warranty policy or product liability laws. 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 chemistry analyzers. Therefore, even if a mass defect within a lot or lots of reagent discs were detected by our Piccolo and VetScan chemistry analyzers, the replacement of such reagent discs free of charge would be costly and could materially harm our financial condition. Further, in the event that a product defect is not detected in our Piccolo chemistry analyzer, 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 current 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 could subject us to claims above the amount of our coverage and would materially adversely affect our business and our financial condition.

We must effectively train and integrate the members of our sales team in order to achieve our anticipated revenue or expand our business.

As of June 30, 2008, we had 65 full-time sales personnel directly involved in our sales and marketing activities, many of whom have been employed by us for a limited period of time. In addition, we experience significant turnover in our sales and marketing personnel. If we are to increase our direct 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 chemistry analyzers. Historically, we have developed reagent discs suitable for the human medical and veterinary diagnostic markets. We have received 510(k) clearances from the U.S. Food and Drug Administration (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 primarily on distributors to sell our products and we rely on sole distributor arrangements in a number of countries. Our failure to successfully develop and maintain these relationships could adversely affect our business.

We sell our medical and veterinary products primarily through a limited number of 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.

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We depend on a number of distributors in the United States who distribute our VetScan products. Our largest distributor in the United States, DVM Resources, accounted for 15% of our total worldwide revenues for the three months ended June 30, 2007. During the three months ended June 30, 2008, there were no distributors or direct customers that accounted for more than 10% of total worldwide revenues. While we continue to enter into arrangements with veterinary distributors, we have also terminated our distribution relationship with the veterinary division of Henry Schein in May 2006. While we have in the past, and expect to in the future, support those customers who were previously supplied products by Henry Schein through our current distributor base and direct service, the loss of these customers 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 or delay in our sales revenue.

In the United States medical market, we depend on a few distributors for our Piccolo products. We entered into formal distribution agreements with the following distributors to sell and market Piccolo chemistry analyzers and medical reagent discs: National Distribution & Contracting, Inc. in our third quarter of fiscal 2008, McKesson Medical-Surgical Inc. in our first quarter of fiscal 2008, Cardinal Health in our fourth quarter of fiscal 2007, Henry Schein s Medical Group in our first quarter of fiscal 2007 and PSS World Medical, Inc. in our third quarter of fiscal 2006. We depend on these distributors to assist us in promoting market acceptance of our Piccolo chemistry analyzers.

Internationally, we rely on only a few distributors for our products in both the medical and veterinary diagnostic markets. In the first quarter of fiscal 2008 we terminated our distributor agreement with T. Chatani & Co., Ltd. (T. Chatani) in Japan. T. Chatani had agreed to continue to service Abaxis customers, which included selling our reagent discs and hematology reagent kits, for a limited period, which ended during the fourth quarter of fiscal 2008. In October 2007, we signed an exclusive distribution agreement with Central Scientific Commerce, Inc. (CSC) to distribute the complete line of our medical and veterinary products in Japan. In the third quarter of fiscal 2008, CSC began the process of registering our new instruments, the VetScan VS2, VetScan HM5 and Piccolo xpress in Japan. The registration process was completed in the first quarter of fiscal 2009, and consequently, CSC can begin to import and market our instruments along with our reagent discs and kits. However, we cannot assure you that our new distribution relationship with CSC will be as successful as our prior distribution arrangement, or at all. Furthermore, an inability of, or any delays by, our distributor in receiving the necessary approvals for our new or other products can adversely impact our revenues in Japan.

We currently rely on distributors that carry either our medical or veterinary products in the following countries: Australia, Austria, Bahrain, Belgium, Canada, Czech Republic, Denmark, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Korea, Macao, the Netherlands, New Zealand, the Philippines, Portugal, Romania, Russia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, Ukraine, United Arab Emirates, the United Kingdom and the United States. Our distributors in each of these countries are responsible for obtaining the necessary approvals to sell our new and existing products. These distributors may not be successful in obtaining proper approvals for our new and existing 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 on favorable terms, or at all. In addition, our distributors may terminate their relationship with us at any time. Historically, we have experienced a high degree of turnover among our international distributors. This 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 limited or 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 components 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, 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 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 stand-alone products: 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 Chemistry Analyzer Components: Our blood analyzer products use several technologically-advanced components that we currently purchase from a limited number of vendors, including components from Hamamatsu Corporation and PerkinElmer, Inc. and components from a single-source supplier, UDT Sensors (a division of OSI Optoelectronics). Our analyzers also use a printer that is primarily made by Seiko North America Corporation. The loss of the supply of any of these components could force us to redesign our blood chemistry analyzers.

Hematology Instruments and Reagents: Our hematology instruments are manufactured by Diatron Messtechnik GmbH in Hungary and are purchased by us as a completed instrument. In addition, to date, we have qualified only three suppliers to produce the reagents for our hematology instruments: Clinical Diagnostic Solutions, Inc., Diatron and Mallinckrodt Baker BV.

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We operate on a purchase order basis with all of the suppliers of our molded plastic reagent discs, reagent chemicals, blood chemistry analyzer components, hematology instruments and hematology reagents and, therefore, 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 may be potential alternate suppliers available for these critical components, to date we have not qualified additional vendors beyond those referenced above and cannot assure you we would be able to enter into arrangements with additional vendors on favorable terms, or at all.

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

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 (a listing of our competitors is listed below).

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 we believe customers typically use to evaluate our products and those of our competitors. These factors include:

- range of tests offered;
- 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. In addition, 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.), Kodak (DT60 analyzer), Polymedco, Inc. and F. Hoffman-La Roche (Reflotron system). 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 significantly improve our direct sales force in order to compete in these markets.

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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 (the CMS) set 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 would 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 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 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 June 30, 2008, we have received market clearance from the FDA for our Piccolo chemistry analyzer and 25 reagent tests that we have on 13 reagent discs. We are currently developing additional tests that we will have to clear with the FDA 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 market that product in the United States, which could harm our future sales.

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. In addition, various state regulatory agencies may regulate the manufacture of our products. To date, we have complied with the following federal, state, local and international regulatory requirements:

- 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 March 2003 and September 2005, the FDA conducted a facility inspection and verified our compliance with the 21 CFR 820 Regulation.
- In November 2006, we received our recertification to the ISO 13485:2003 Quality System Standard for medical devices.

We cannot assure you that we will successfully pass any re-inspection by the 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.

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Effects of the Clinical Laboratory Improvement Amendments on Our Products

Our Piccolo products are also affected by the Clinical Laboratory Improvement Amendments (the CLIA) of 1988. The CLIA are intended to insure the quality and reliability of all medical testing in the United States regardless of where the tests are performed. The current CLIA regulations divide laboratory tests into the following three categories:

- waived;
- moderately complex; and
- highly complex.

Many of the tests performed using the Piccolo chemistry analyzer 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 CMS. After the testing facility receives a laboratory certification, it must then meet the 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 fiscal 2008, the FDA granted waived status under CLIA regulations for the following analytes when used in conjunction with the Piccolo xpress and Piccolo Classic chemistry analyzers for the medical market: chloride (CL-), potassium (K+), sodium (NA+) and total carbon dioxide (tCO_2). Prior to fiscal 2008, the FDA granted waived status under CLIA regulations for the following tests when used in conjunction with our Piccolo chemistry analyzer: alanine aminotransferase (ALT), albumin (ALB), alkaline phosphatase (ALP), amylase (AMY), aspartate aminotransferase (AST), calcium (CA), creatinine (CRE), gamma glutamyltransferase (GGT), glucose (GLU), high-density lipoprotein cholesterol (HDL), total bilirubin (TBIL), total protein (TP), triglycerides (TRIG), total cholesterol (CHOL), urea nitrogen (BUN) and uric acid (UA). Accordingly, we can offer the following Piccolo reagent discs as waived tests to the medical market: Basic Metabolic Panel, Comprehensive Metabolic Panel, Electrolyte Panel, General Chemistry 6, General Chemistry 13, Kidney Check, Lipid Panel, Lipid Panel Plus and Liver Panel Plus. Waived status permits untrained personnel to run the Piccolo chemistry analyzer using these tests; thus, extending the sites (doctors offices and other point-of-care environments) that can use the Piccolo chemistry analyzer.

Although we are engaged in an active program to test and apply for CLIA waivers for additional analytes, we cannot assure you that we will successfully receive CLIA 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.

Need to Comply with 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. Foreign certifications that we have received include the following, among others:

- 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 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 November 2006, we received our recertification to the ISO 13485:2003 Quality System Standard for medical devices.

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 FDA and of the State of California, including the Quality System Regulation, current regulations depend on administrative interpretations. Future interpretations made by the FDA, CMS or other regulatory bodies may adversely affect our business.

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We have incurred and may continue to incur, in future periods, significant share-based compensation charges under SFAS No. 123(R), which may adversely affect our reported financial results.

Effective April 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)), issued by the Financial Accounting Standards Board, which requires the measurement of all share-based payments to employees, using a fair-value-based method and the recording of such expense in our results of operations. The fair value of restricted stock unit awards used in our expense recognition method is measured based on the number of shares granted and the closing market price of our common stock on the date of grant. Such value is recognized as an expense, net of an estimated forfeiture rate, for those shares expected to vest over the corresponding requisite service period. Our policy is to recognize the expense of restricted stock unit grants based on the vested portions of the awards. Since fiscal 2007, we granted restricted stock unit awards annually to employees based on the following time-based vesting schedule over a four-year period: five percent vesting after the first year; additional ten percent after the second year; additional 15 percent after the third year; and the remaining 70 percent after the fourth year of continuous employment. During fiscal 2007, 2008 and the first quarter of fiscal 2009, share-based compensation expense related to restricted stock units had a material impact on our earnings per share and on our financial statements and we expect that it will continue to adversely impact our reported results of operations, particularly in the fourth year of vesting for the restricted stock unit awarded to employees. As of June 30, 2008, our total unrecognized compensation expense related to restricted stock unit awards granted to employees and directors to date totaled $13.2 million, which is expected to be recognized over a weighted average period of 2.80 years.

We depend on key members of our management and scientific staff and, if we fail to retain and recruit qualified individuals, our ability to execute our business strategy and generate sales would 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. We may not be able to continue to attract and retain skilled and experienced marketing, sales and manufacturing personnel on acceptable terms in the future because numerous medical products and other high technology companies compete for the services of these qualified individuals. We currently do not maintain key man life insurance on any of our employees.

We are subject to increasingly complex requirements from recent legislation requiring companies to evaluate internal control over financial reporting.

Rules adopted by the Securities and Exchange Commission pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 require an assessment of internal control over financial reporting by our management and an attestation of the effectiveness of our internal controls over financial reporting by an independent registered public accounting firm. We have an ongoing program to perform the assessment, testing and evaluation to comply with these requirements and we expect to continue to incur significant expenses to Section 404 compliance on an ongoing basis.

Our management assessed the effectiveness of our internal control over financial reporting as of our fiscal years ended March 31, 2008 and 2007. Although we received an unqualified opinion on our financial statements for the fiscal years ended March 31, 2008 and 2007, and on the effectiveness of our internal control over financial reporting as of March 31, 2008 and 2007, we cannot predict the outcome of our testing in future periods. In the event that our internal controls over financial reporting are not effective as defined under Section 404, or 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 to meet our reporting obligations in the future. If management cannot assess internal control over financial reporting is effective, or our independent registered public accounting firm is unable to provide an unqualified attestation report on such assessment, investor confidence and our share value may be negatively impacted.

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 12 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 under the subheading

Management s Discussion and Analysis of Financial Condition and Results of Operations in this Quarterly Report on Form 10-Q.

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;

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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 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), which cost approximately $90,000 in fiscal 2008, and includes other environmental health and safety expenses 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 blood chemistry analyzers or the reagent discs used in the blood chemistry 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 location in Union City, California experienced a system failure or regulatory problem that temporarily shuts 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 currently primarily 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 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.

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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 quarter ended June 30, 2008, the closing sale prices of our common stock on the NASDAQ Global Market ranged from $23.31 to $30.48 per share and the closing sale price for our quarter ended June 30, 2008 was $24.13 per share. During the last eight fiscal quarters ended June 30, 2008, our stock price closed at a high of $39.74 on December 24, 2007 and a low of $17.00 on January 25, 2007. Many factors may affect the market price of our common stock, including:

- fluctuation in our operating results;
- announcements of technological innovations or new commercial products by us or our competitors;
- changes in governmental regulation in the United States and internationally;
- 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 our patents or our other proprietary rights;
- product liability claims and 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 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

Not applicable.

Item 5. Other Information

Not applicable.

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Item 6. Exhibits

Exhibit No.	Description of Document
3.1	Restated Articles of Incorporation (Filed with the Securities and Exchange Commission as an exhibit with our Annual Report on Form 10-K for the fiscal year ended March 31, 1993 and incorporated herein by reference.)
3.2	By-laws (Filed with the Securities and Exchange Commission in our Registration Statement No. 33-44326 on December 11, 1991 and incorporated herein by reference.)
3.3	Amendment to the By-laws (Filed with the Securities and Exchange Commission as an exhibit with our Current Report on Form 8-K on July 30, 2007 and incorporated herein by reference.)
4.1	Registration Rights Agreement, dated as of March 29, 2002 (Filed with the Securities and Exchange Commission as an exhibit with our Current Report on Form 8-K on May 13, 2002 and incorporated herein by reference.)
4.2	Reference is made to Exhibit 3.1, Exhibit 3.2 and Exhibit 3.3.
10.1*	Fiscal 2009 Base Salary and Target Bonus for the Named Executive Officers (Filed with the Securities and Exchange Commission as an exhibit with our Current Report on Form 8-K on April 29, 2008 and incorporated herein by reference.)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1#	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2#	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Management contract or compensatory plan or arrangement.

\# This certification accompanies this Quarterly Report on Form

10-Q. The certification is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Abaxis, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Quarterly Report on Form 10-Q and irrespective of any general incorporation language contained in any such filing.

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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: August 8, 2008

BY: /s/ Clinton H. Severson
Clinton H. Severson
President, Chief Executive Officer and Director
(Principal Executive Officer)

Date: August 8, 2008

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

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