UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2006

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission File Number: 001-32541

HEMOSENSE, INC.

(Exact name of registrant as specified in its charter)

Delaware	**77-0452938**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

651 River Oaks Parkway, San Jose, California 95134

(Address of principal executive offices) (Zip Code)

(408) 719-1393

(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 x No ¨

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

Large accelerated Filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of August 4, 2006 11,204,233 shares of the registrant s common stock were outstanding.

Table of Contents

HEMOSENSE, INC.

INDEX

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED FINANCIAL STATEMENTS

HEMOSENSE, INC.

UNAUDITED CONDENSED BALANCE SHEETS

(in thousands, except per share and share data)

	June 30, 2006	September 30, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 1,694	$ 3,598
Short term investments	10,377	7,943
Accounts receivable	3,089	2,087
Prepaid expenses and other current assets	404	714
Inventories	2,188	2,744
Total current assets	17,752	17,086
Property and equipment, net	433	512
Technology licenses and prepaid royalties	359	1,179
Other assets	146	226
Total assets	$ 18,690	$ 19,003
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 333	$ 1,029
Accrued expenses and other liabilities	1,681	1,159
Capital lease, current portion	41	37
Borrowings, current portion	2,259	2,000
Total current liabilities	4,314	4,225
Capital lease, net of current portion	22	52
Borrowings, net of current portion	3,069	4,714
Other long term liabilities	204	
Total liabilities	7,609	8,991
Stockholders equity:		
Common stock, $0.001 par value; Authorized: 50,000,000 shares; Issued and outstanding: 11,204,233 and 9,604,989 at June 30, 2006 and September 30, 2005, respectively	11	10
Additional paid-in capital	66,635	57,191
Accumulated other comprehensive loss	(17)	(3)
Accumulated deficit	(55,548)	(47,186)
Total shareholders equity	11,081	10,012
Total liabilities and shareholders equity	$ 18,690	$ 19,003

The accompanying notes are an integral part of these unaudited condensed financial statements.

Table of Contents

HEMOSENSE, INC.

UNAUDITED CONDENSED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Nine Months Ended June 30, 2006	Nine Months Ended June 30, 2005
Revenue	$ 4,571	$ 2,454	$ 12,049	$ 5,871
Cost of goods sold	3,513	2,487	8,880	6,826
Gross profit (loss)	1,058	(33)	3,169	(955)
Operating expenses:				
Research and development	769	266	1,913	806
Sales and marketing	2,058	1,677	5,954	4,877
General and administrative	1,139	449	3,181	1,321
Total operating expenses	3,966	2,392	11,048	7,004
Loss from operations	(2,908)	(2,425)	(7,879)	(7,959)
Interest income	144	8	450	18
Interest & other expense, net	(287)	(530)	(933)	(971)
Net loss	$ (3,051)	$ (2,947)	$ (8,362)	$ (8,912)
Net loss per share:				
Basic and diluted	$ (0.27)	$ (5.29)	$ (0.76)	$ (19.59)
Shares used to compute net loss per share:				
Basic and diluted	11,197	557	10,971	455

The accompanying notes are an integral part of these unaudited condensed financial statements.

Table of Contents

HEMOSENSE, INC.

UNAUDITED CONDENSED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended June 30, 2006	2005
Cash flows from operating activities:		
Net loss	$ (8,362)	$ (8,912)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	578	952
Amortization of debt issuance costs	117	279
Provision/write-off of inventories	(6)	105
Amortization of prepaid royalties	695	229
Accrued interest on note payable	85	70
Stock compensation cost	199	
Changes in current assets and liabilities:		
Accounts receivable	(1,002)	(434)
Prepaid expenses and other assets	273	(255)
Inventories	575	(698)
Accounts payable	(696)	390
Accrued expenses and other liabilities	522	159
Net cash used in operating activities	(7,022)	(8,115)
Cash flows from investing activities:		
Proceeds from sale of short term investments	15,954	
Purchase of short term investments	(18,402)	
Acquisition of property and equipment	(170)	(216)
Net cash used in investing activities	(2,618)	(216)
Cash flows from financing activities:		
Proceeds from issuance of common stock and warrants	9,233	33
Proceeds from issuance of preferred stock, net of issuance cost		3,331
Principal payments on capital lease obligation	(26)	(29)
Proceeds from borrowing		6,093
Repayment of borrowings	(1,471)	(910)
Net cash provided by financing activities	7,736	8,518
Net increase (decrease) in cash and cash equivalents	(1,904)	187
Cash and cash equivalents at beginning of period	3,598	433
Cash and cash equivalents at end of period	$ 1,694	$ 620

The accompanying notes are an integral part of these unaudited condensed financial statements.

5

Table of Contents

HEMOSENSE, INC.

NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS

1) Organization and Basis of Presentation

Description of the Company

HemoSense, Inc., (the Company) was incorporated in the state of Delaware on March 4, 1997 to develop, manufacture and sell easy-to-use, handheld blood coagulation monitoring systems for use by healthcare professionals and patients in the management of warfarin medication. The Company began selling its first product, the INRatio meter and related test strips, in March 2003. Prior to that date, the Company was in the development stage and had been primarily engaged in developing its product technology and raising capital.

Basis of Presentation

The accompanying unaudited condensed financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. With the exception of Statement of Financial Accounting Standards, No. 123(R), which was adopted October 1, 2005, the unaudited interim financial statements have been prepared on the same basis as the annual financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments necessary for the fair statement of the financial statements, have been included. The results of operations of any interim period are not necessarily indicative of the results of operations for the full year or any other interim period. Further, the preparation of unaudited condensed financial statements requires management to make estimates and assumptions that affect the recorded amounts reported therein. Actual results could differ from those estimates. A change in facts or circumstances surrounding the estimate could result in a change to estimates and impact future operating results.

The financial statements and related disclosures have been prepared with the presumption that users of the interim financial statements have read or have access to the audited financial statements for the preceding fiscal year. Accordingly, these financial statements should be read in conjunction with the audited financial statements and notes thereto for the year ended September 30, 2005 included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission. The results of operations for the three and nine month periods ended June 30, 2006 are not necessarily indicative of the results for the year ending September 30, 2006 or any future interim period.

2) Summary of Significant Accounting Policies

The Company s significant accounting policies are disclosed in its Annual Report on Form 10-K for the year ended September 30, 2005, which was filed with the Securities and Exchange Commission. With the exception of Statement of Financial Accounting Standards (SFAS) 123(R) (SFAS 123(R)) which was adopted October 1, 2005, the Company s significant accounting policies have not materially changed since September 30, 2005.

Warranty

The Company records an accrual for estimated warranty costs when revenue is recognized. Warranty covers replacement costs of defective meters and related test strips. The warranty period is generally one year. The Company has processes in place to estimate accruals for warranty exposure. The processes include estimated failure rates and replacement costs, and known design changes. Although the Company believes it has the ability to reasonably estimate warranty expenses, unforeseen changes in factors impacting the estimate for warranty could occur and such changes could cause a material change in the Company s warranty accrual estimate. Such a change would be recorded in the period in which the change was identified. Changes in the Company s product warranty liability during the three and nine month periods ended June 30, 2006 and June 30, 2005, were as follows (in thousands):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2006	**2005**	**2006**	**2005**

Balance, at the beginning of the period	$ 70	$ 10	$ 59	$ 6
Accruals and charges for warranty for the period	23	21	65	50
Cost of repairs and replacements	(27)	(18)	(58)	(43)
Balance, at the end of the period	66	$ 13	$ 66	$ 13

6

Table of Contents

Balance Sheet Data

Inventories

The components of inventories are as follows (in thousands):

	June 30, 2006	September 30, 2005
Raw materials	$ 906	$ 881
Work-in-process	1,000	1,138
Finished goods	282	725
	$ 2,188	$ 2,744

3) Stock-Based Compensation

Stock Option Plans

1997 Stock Option Plan

In 1997, the Company adopted the 1997 Stock Option Plan (the 1997 Plan), as amended, under which 1.1 million shares of the Company s common stock were reserved for issuance to employees, directors and consultants. Options granted under the 1997 Plan may be designated as either incentive stock options or non-statutory stock options. Stock purchase rights could also be granted under the 1997 Plan. Incentive stock options could only be granted to employees. Options granted or stock purchased under the 1997 Plan must become exercisable or the Company s right to repurchase must lapse no less than 20% after one year and ratably over 4 years thereafter. In addition, as of June 30, 2006 there were 125,920 unvested shares underlying stock options granted under the 1997 Plan to certain employees and directors in which the vesting will fully accelerate upon the occurrence of a change in control. The exercise price of incentive stock options and non-statutory stock options shall be no less than 100% and 85%, respectively, of the fair value per share of the Company s common stock on the grant date, as determined by the Company s board of directors. The term of the options is ten years. Since the implementation of the 2005 Equity Incentive Plan, no additional options will be granted from the 1997 Plan and the 1997 Plan will terminate when all the shares have been either exercised, cancelled or expire.

2005 Equity Incentive Plan

In March 2005, the Company s board of directors and stockholders approved the 2005 Equity Incentive Plan (the 2005 Plan), which became effective upon completion of the Company s initial public offering on July 1, 2005. As of June 30, 2006 there were 154,898 unvested shares underlying stock options granted under the 2005 Plan to certain employees and directors in which the vesting will fully accelerate upon the occurrence of a change in control. The Company has reserved a total of 530,000 shares of its common stock for issuance under the 2005 Plan, 304,000 shares of which are available for future grant. In addition, any unused shares in or any unvested shares under the 1997 Plan as of the effective date of the Company s initial public offering were added to the 2005 Plan.

Stock-Based Compensation

Effective October 1, 2005, the Company adopted SFAS 123(R), using the modified prospective application transition method, which establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation cost is measured at the beginning of the requisite service period, based on the fair value of the award and is expensed over the requisite service period, which is generally the vesting period. The Company previously applied Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* and related Interpretations, as permitted by SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123).

Table of Conten