BIOANALYTICAL SYSTEMS INC
Form 10-Q
February 16, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended December 31, 2015

OR

.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from ___________ to _____________.

Commission File Number 000-23357

BIOANALYTICAL SYSTEMS, INC.

(Exact name of the registrant as specified in its charter)

INDIANA (State or other jurisdiction of incorporation or organization)	35-1345024 (I.R.S. Employer Identification No.)
2701 KENT AVENUE WEST LAFAYETTE, INDIANA (Address of principal executive offices)	47906 (Zip code)

(765) 463-4527

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨

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 ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller Reporting Company x

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

As of February 11, 2016, 8,107,677 of the registrant's common shares were outstanding.

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BIOANALYTICAL SYSTEMS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	December 31, 2015 (Unaudited)	September 30, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 403	$ 438
Accounts receivable		
Trade, net of allowance of $559 at December 31, 2015 and September 30, 2015, respectively	1,591	2,904
Unbilled revenues and other	988	1,110
Inventories	1,434	1,466
Prepaid expenses	430	773
Total current assets	4,846	6,691
Property and equipment, net	15,802	15,989
Goodwill	1,009	1,009
Debt issue costs	87	94
Other assets	31	32
Total assets	$ 21,775	$ 23,815
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	$ 2,462	$ 2,858
Accrued expenses	982	1,710
Customer advances	2,724	3,414
Income tax accruals	8	30
Revolving line of credit	824	86
Fair value of warrant liability	100	189
Current portion of capital lease obligation	173	230
Current portion of long-term debt	4,256	786
Total current liabilities	11,529	9,303
Fair Value of interest rate swap	27	50
Capital lease obligation, less current portion	58	68
Long-term debt, less current portion	—	3,666
Total liabilities	11,614	13,087
Shareholders' equity:		

Preferred shares, authorized 1,000,000 shares, no par value:		
1,185 Series A shares at $1,000 stated value issued and outstanding at December 31, 2015 and September 30, 2015, respectively	1,185	1,185
Common shares, no par value:		
Authorized 19,000,000 shares; 8,107,558 issued and outstanding at December 31, 2015 and 8,105,007 at September 30, 2015	1,991	1,988
Additional paid-in capital	21,209	21,193
Accumulated deficit	(14,197)	(13,691)
Accumulated other comprehensive income (loss)	(27)	53
Total shareholders' equity	10,161	10,728
Total liabilities and shareholders' equity	$ 21,775	$ 23,815

The accompanying notes are an integral part of the condensed consolidated financial statements.

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BIOANALYTICAL SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME (LOSS)

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended December 31, 2015	2014
Service revenue	$ 4,055	$ 4,398
Product revenue	840	1,447
Total revenue	4,895	5,845
Cost of service revenue	3,339	3,256
Cost of product revenue	572	685
Total cost of revenue	3,911	3,941
Gross profit	984	1,904
Operating expenses:		
Selling	307	336
Research and development	157	191
General and administrative	1,049	1,235
Total operating expenses	1,513	1,762
Operating income (loss)	(529)	142
Interest expense	(66)	(81)
Change in fair value of warrant liability – decrease	89	120
Other income	1	2
Income (loss) before income taxes	(505)	183
Income taxes	1	1
Net income (loss)	$ (506)	$ 182
Other comprehensive income (loss)	(80)	32
Comprehensive income (loss)	$ (586)	$ 214
Basic net income (loss) per share	$ (0.06)	$ 0.02
Diluted net income (loss) per share	$ (0.06)	$ 0.01

Weighted common shares outstanding:		
Basic	8,107	8,076
Diluted	8,107	9,601

The accompanying notes are an integral part of the condensed consolidated financial statements.

BIOANALYTICAL SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended December 31, 2015	2014
Operating activities:		
Net income (loss)	$ (506)	$ 182
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	342	377
Decrease in fair value of warrant liability	(89)	(120)
Employee stock compensation expense	15	29
Loss on sale of property and equipment	11	—
Provision for doubtful accounts	(39)	—
Changes in operating assets and liabilities:		
Accounts receivable	1,474	(355)
Inventories	32	(98)
Income tax accruals	(22)	(3)
Prepaid expenses and other assets	351	(9)
Accounts payable	(499)	228
Accrued expenses	(728)	(498)
Customer advances	(690)	106
Net cash used by operating activities	(348)	(161)
Investing activities:		
Capital expenditures	(166)	(122)
Net cash used by investing activities	(166)	(122)
Financing activities:		
Proceeds from exercise of stock options	4	—
Payments of long-term debt	(196)	(196)
Payments on revolving line of credit	(2,473)	(1,097)
Borrowings on revolving line of credit	3,211	1,375
Payments on capital lease obligations	(67)	(75)
Net cash provided by financing activities	479	7
Effect of exchange rate changes	—	42
Net decrease in cash and cash equivalents	(35)	(234)

Cash and cash equivalents at beginning of period	438	981
Cash and cash equivalents at end of period	$ 403	$ 747

The accompanying notes are an integral part of the condensed consolidated financial statements.

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BIOANALYTICAL SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except per share data or as otherwise indicated)

(Unaudited)

1. DESCRIPTION OF THE BUSINESS AND BASIS OF PRESENTATION

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

We have prepared the accompanying unaudited interim condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles (“GAAP”), and therefore should be read in conjunction with our audited consolidated financial statements, and the notes thereto, included in the Company’s annual report on Form 10-K for the year ended September 30, 2015. In the opinion of management, the condensed consolidated financial statements for the three months ended December 31, 2015 and 2014 include all adjustments which are necessary for a fair presentation of the results of the interim periods and of our financial position at December 31, 2015. The results of operations for the three months ended December 31, 2015 may not be indicative of the results for the year ending September 30, 2016.

On May 14, 2014, we entered into a Credit Agreement (“Agreement”) with Huntington Bank. The Agreement includes both a term loan and a revolving loan and is secured by mortgages on our facilities in West Lafayette and Evansville, Indiana and liens on our personal property. As of December 31, 2015, we were not in compliance with certain financial covenants of the Agreement. On February 10, 2016, Huntington Bank advised us that the failure to meet these financial covenants constitutes an event of default under the Agreement and that they have reserved all of their rights with respect thereto, but Huntington Bank has not exercised its available remedies to date.. These remedies include the ability to accelerate the outstanding debt under our term loan and revolving loan, to exercise their security interest and collect on the underlying collateral, to refrain from making additional advances under the revolving loan and to terminate our interest rate swap. Were Huntington Bank to accelerate the outstanding debt, we would have insufficient funds to satisfy that obligation, and their exercise of alternative remedies could also have a material adverse effect on our operations and financial condition. As a result, we have classified the entire term loan payable to Huntington Bank as a current liability of the Company

2. MANAGEMENT’S PLAN

The Company's unaudited interim condensed consolidated financial statements were prepared on a going concern basis, which assumes continuity of operations and realization of assets and satisfaction of liabilities in the ordinary course of business. As noted above, Huntington Bank has advised us that the failure to meet financial covenants pertaining to our credit facility constitutes an event of default under the Agreement and has reserved all of its rights with respect thereto. Although Huntington Bank has not exercised its available remedies to date, these circumstances raise substantial doubt about the Company's ability to continue as a going concern, and management has and will continue to take measures to mitigate that possibility.

The Company is engaged in exploring initiatives to address solutions to our credit issues, which includes the evaluation and pursuit of various sources of financing. Management is also undergoing a detailed review of all current pricing strategies and market programs and has begun new initiatives designed to increase revenue. Lastly, management has been, and continues to be actively engaged in driving operating costs lower by more effectively controlling operating costs and manpower costs.

Management is in discussion with Huntington Bank to secure a forbearance whereby Huntington Bank would agree for a limited time period to forbear from exercising certain of their rights and remedies under the credit facility available to Huntington as a result of the non-compliance. A forbearance agreement would provide management with additional time to engage in discussions with Huntington Bank and other parties regarding restructuring or replacing our debt, including amounts outstanding under the revolving loan scheduled to mature in May 2016, and to explore alternative liquidity solutions.

3. STOCK-BASED COMPENSATION

The Company's 2008 Stock Option Plan ("the Plan") is used to promote our long-term interests by providing a means of attracting and retaining officers, directors and key employees and aligning their interests with those of our shareholders. The Plan is described more fully in Note 9 in the Notes to the Consolidated Financial Statements in our Form 10-K for the year ended September 30, 2015. All options granted under the Plan had an exercise price equal to the market value of the underlying common shares on the date of grant. We expense the estimated fair value of stock options over the vesting periods of the grants. We recognize expense for awards subject to graded vesting using the straight-line attribution method, reduced for estimated forfeitures. Forfeitures are revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates and an adjustment is recognized at that time. The Compensation Committee may also issue non-qualified stock option grants with vesting periods different from the 2008 Plan. As of December 31, 2015, there are 30 shares underlying options outstanding that were granted outside of the Plan. The assumptions used are detailed in Note 9 to the Consolidated Financial Statements in our Form 10-K for the year ended September 30, 2015. Stock based compensation expense for the three months ended December 31, 2015 and 2014 was $15 and $29, respectively.

A summary of our stock option activity for the three months ended December 31, 2015 is as follows (in thousands except for share prices):

	Options (shares)	Weighted-Average Exercise Price	Weighted-Average Grant Date Fair Value
Outstanding - October 1, 2015	319	$ 1.73	$ 1.38
Exercised	(3)	$ 1.14	$ 0.95
Granted	—	—	—
Terminated	—	—	
Outstanding - December 31, 2015	316	$ 1.73	$ 1.38

4. INCOME (LOSS) PER SHARE

We compute basic income (loss) per share using the weighted average number of common shares outstanding. The Company has three categories of dilutive potential common shares: the Series A preferred shares issued in May 2011 in connection with a registered direct offering, the Warrants issued in connection with the same offering in May 2011, and shares issuable upon exercise of options. We compute diluted earnings per share using the if-converted method for preferred stock and the treasury stock method for stock options and warrants. Shares issuable upon exercise of options were not considered in computing diluted earnings per share for the quarter ended December 31, 2015 because they were anti-dilutive. Warrants for 799 common shares and 592 common shares issuable upon conversion of preferred shares were not considered in computing diluted earnings per share for the quarter ended December 31, 2015 because they were also anti-dilutive.

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

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	Three Months Ended December 31, 2015	2014
Basic net income (loss) per share:		
Net income (loss) applicable to common shareholders	$ (506)	$ 182
Weighted average common shares outstanding	8,107	8,076
Basic net income (loss) per share	$ (0.06)	$ 0.02
Diluted net income (loss) per share:		
Net income (loss) applicable to common shareholders	$ (506)	$ 182
Change in Fair Value of Warrant Liability	—	(120)
Diluted net income (loss) applicable to common shareholders	$ (506)	$ 62
Weighted average common shares outstanding	8,107	8,076
Plus: Incremental shares from assumed conversions		
Series A preferred shares	—	592
Class A warrants	—	799
Dilutive stock options/shares	—	134
Diluted weighted average common shares outstanding	8,107	9,601
Diluted net income (loss) per share	$ (0.06)	$ 0.01

5. INVENTORIES

Inventories consisted of the following:

	December 31, 2015	September 30, 2015
Raw materials	$ 1,094	$ 1,112
Work in progress	247	247
Finished goods	390	408
	$ 1,731	$ 1,767
Obsolescence reserve	(297)	(301)
	$ 1,434	$ 1,466

6. SEGMENT INFORMATION

We operate in two principal segments - research services and research products. Our Services segment provides research and development support on a contract basis directly to pharmaceutical companies. Our Products segment provides liquid chromatography, electrochemical and physiological monitoring products to pharmaceutical companies, universities, government research centers and medical research institutions. Our accounting policies in these segments are the same as those described in the summary of significant accounting policies found in Note 2 to Consolidated Financial Statements in our annual report on Form 10-K for the year ended September 30, 2015.

	Three Months Ended December 31, 2015	2014
Revenue:		
Service	$ 4,055	$ 4,398
Product	840	1,447
	$ 4,895	$ 5,845
Operating income (loss):		
Service	$ (322)	$ 18
Product	(207)	124
	$ (529)	$ 142
Interest Expense	(66)	(81)
Change in fair value of warrant liability – decrease	89	120
Other income	1	2
Income (loss) before income taxes	$ (505)	$ 183

7. INCOME TAXES

We use the asset and liability method of accounting for income taxes. We recognize deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. We measure deferred tax assets and liabilities 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. We recognize the effect on deferred tax assets and liabilities of a change in tax rates in income in the period that includes the enactment date. We record valuation allowances based on a determination of the expected realization of tax assets.

We recognize the tax benefit from an uncertain tax position only if it is more likely than not to be sustained upon examination based on the technical merits of the position. We measure the amount of the accrual for which an exposure exists as the largest amount of benefit determined on a cumulative probability basis that we believe is more likely than not to be realized upon ultimate settlement of the position.

At December 31, 2015 and September 30, 2015, we had a $16 liability for uncertain income tax positions. The difference between the federal statutory rate of 34% and our effective rate of (0.2)% is due to changes in our valuation allowance on our net deferred tax assets.

We record interest and penalties accrued in relation to uncertain income tax positions as a component of income tax expense. Any changes in the liability for uncertain tax positions would impact our effective tax rate. We do not expect the total amount of unrecognized tax benefits to significantly change in the next twelve months.

We file income tax returns in the U.S. and several U.S. States. We remain subject to examination by taxing authorities in the jurisdictions in which we have filed returns for years after 2010.

8. DEBT

Credit Facility

On May 14, 2014, we entered into a Credit Agreement ("Agreement") with Huntington Bank. The Agreement includes both a term loan and a revolving loan and is secured by mortgages on our facilities in West Lafayette and Evansville, Indiana and liens on our personal property. As of December 31, 2015, we were not in compliance with certain financial covenants of the Agreement. Huntington Bank has advised us that the failure to meet these financial covenants constitutes an event of default under the Agreement and has reserved all of its rights with respect thereto, but has not exercised available remedies to date. These remedies include the ability to accelerate the outstanding debt under our term loan and revolving loan, to exercise their security interest and collect on the underlying collateral, to refrain from making additional advances under the revolving loan and to terminate our interest rate swap. Were Huntington Bank to accelerate the outstanding debt, we would have insufficient funds to satisfy that obligation, and their exercise of alternative remedies could also have a material adverse effect on our operations and financial condition.

Management is in discussion with Huntington Bank to secure a forbearance whereby Huntington Bank would agree for a limited time period to forbear from exercising certain of its rights and remedies under the Agreement, including the right to declare outstanding indebtedness thereunder immediately due. A forbearance agreement would provide management with additional time to engage in discussions with Huntington Bank and other parties regarding restructuring or replacing our debt, including amounts outstanding under the revolving loan scheduled to mature in May 2016, and to explore alternative liquidity solutions. There can be no assurance that we will be able to complete initiatives to resolve our credit issues on satisfactory terms, or at all. If we are unable to negotiate a forbearance and execute on initiatives to refinance our indebtedness or otherwise rectify our liquidity issues, we may have insufficient funds to satisfy our debt obligations and operate our business.

The term loan for $5,500 bears interest at LIBOR plus 325 basis points with monthly principal payments of approximately $65 plus interest. The term loan matures in May 2019. On May 15, 2014, we used the proceeds from the term loan to pay off prior indebtedness. The balance on the term loan at December 31, 2015 and September 30, 2015 was $4,256 and $4,452, respectively.

The revolving loan for $2,000 matures in May 2016 and bears interest at LIBOR plus 300 basis points with interest paid monthly. The revolving loan also carries a facility fee of .25%, paid quarterly, for the unused portion of the revolving loan. The revolving loan includes an annual clean-up provision that requires the Company to maintain a balance of not more than 20% of the maximum loan of $2,000 for a period of 30 days in any 12 month period while the revolving loan is outstanding. The revolving loan balance was $824 and $ 86 at December 31, 2015 and September 30, 2015, respectively.

On May 14, 2015, we executed a first amendment to the Agreement with Huntington Bank. As amended, the Agreement requires us to maintain a fixed charge coverage ratio of not less than 1.05 to 1.00 for the fiscal quarters ending June 30, 2015, September 30, 2015 and December 31, 2015 and not less than 1.10 to 1.00 for the fiscal quarter ending March 31, 2016 until maturity. The fixed charge coverage ratio calculation excludes up to $1,000 in capital expenditures related to the building renovation costs associated with our lease agreement with Cook Biotech, Inc. executed in January 2015. The Agreement also requires us to maintain a maximum total leverage ratio of not greater than 3.00 to 1.00 from the date of the Agreement through September 30, 2015 and 2.50 to 1.00 commencing after October 1, 2015 until maturity. The Agreement also contains various other covenants, including restrictions on the incurrence of certain indebtedness, liens, investments, acquisitions, asset sales and cash dividends. As of December 31, 2015, we were not in compliance with the fixed charge coverage ratio and maximum total leverage ratio.

We entered into an interest rate swap agreement with respect to the above loans to fix the interest rate with respect to 60% of the value of the term loan at approximately 5.0%. We entered into this derivative transaction to hedge interest rate risk of the related debt obligation and not to speculate on interest rates. The changes in the fair value of the interest rate swap are recorded in AOCI to the extent effective. We assess on an ongoing basis whether the derivative that is used in the hedging transaction is highly effective in offsetting changes in cash flows of the hedged debt. The terms of the interest rate swaps match the terms of the underlying debt resulting in no ineffectiveness.

We incurred $134 of costs in connection with the issuance of the credit facility. These costs were capitalized and are being amortized to interest expense on a straight-line basis over five years based on the contractual term of the credit facility. As of December 31, 2015 and September 30, 2015, the unamortized portion of debt issuance costs related to the credit facility was $87 and $94, respectively, and was included in Debt issue costs, net on the consolidated balance sheets.

9. RESTRUCTURING

In March 2012, we announced a plan to restructure our bioanalytical laboratory operations. We consolidated our laboratory in McMinnville, Oregon into our 120,000 square foot headquarters facility in West Lafayette, Indiana and closed our facility and bioanalytical laboratory in Warwickshire, United Kingdom. We continue to sell our products globally while further consolidating delivery of our CRO services into our Indiana locations.

We reserved for lease payments at the cease use date for our UK facility and have considered free rent, sublease rentals and the number of days it would take to restore the space to its original condition prior to our improvements. In the first quarter of fiscal 2013, we began amortizing into general and administrative expense, equally through the cease use date, the estimated rent income of $200 when the reserve was originally established. In the first quarter of fiscal 2015, we recorded $20 of the estimated rent income as expense. We have been unsuccessful at subleasing the facility. Based on these matters, we have $1,000 reserved for UK lease related costs at December 31, 2015. We do not expect to accrue additional amounts in fiscal 2016. We have previously communicated with the landlord regarding the nature and timing of rent under the lease. The full restructuring reserve is classified in other accounts payable on the Consolidated Balance Sheets because the full amount is due and payable. The UK building lease expires in 2023 but includes an opt out provision after 7 years, which occurred in the fourth quarter of fiscal 2015 and was exercised.

Other costs of $117 have been accrued for legal and professional fees and other costs estimated to be incurred in connection with transitioning services from sites being closed as well as costs incurred to remove improvements previously made to the UK facility. In fiscal 2015, all related investments in the UK operations were removed domestically.

10. FAIR VALUE OF FINANCIAL INSTRUMENTS

The provisions of the Fair Value Measurements and Disclosure Topic defines fair value, establishes a consistent framework for measuring fair value and provides the disclosure requirements about fair value measurements. This Topic also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company’s judgment about the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the inputs as follows:

- Level 1 – Valuations based on quoted prices for identical assets or liabilities in active markets that the Company has the ability to access.
- Level 2 – Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
- Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

In May 2011, we issued Class A and B Warrants that are measured at fair value on a recurring basis. We recorded these warrants as a liability determining the fair value at inception on May 11, 2011. Subsequent quarterly fair value measurements, using the Black Scholes model which is considered a level 2 measurement, are calculated with fair value changes charged to the statement of operations and comprehensive income (loss). The Class B Warrants expired in May 2012 and the liability was reduced to zero. The assumptions used to compute the fair value of the Class A Warrants at December 31, 2015 and September 30, 2015 were as follows:

	December 31, 2015 Warrant A		September 30, 2015 Warrant A	
Risk-free interest rate	0.31	%	0.14	%
Dividend yield	0.00	%	0.00	%
Volatility of the Company's common stock	73.39	%	65.03	%
Expected life of the options (years)	0.36		0.6	
Fair value per unit	$ .124		$ .236	

The carrying amounts for cash and cash equivalents, accounts receivable, inventories, prepaid expenses and other assets, accounts payable and other accruals approximate their fair values because of their nature and respective duration. The carrying value of the note payable approximates fair value due to the variable nature of the interest rates.

We use an interest rate swap, designated as a hedge, to fix 60% of the debt from our credit facility with Huntington Bank. We did not enter into this derivative transaction to speculate on interest rates, but to hedge interest rate risk. The swap is recognized on the balance sheet at its fair value. The fair value is determined utilizing a cash flow model that takes into consideration interest rates and other inputs observable in the market from similar types of instruments, and is therefore considered a level 2 measurement.

The following table summarizes fair value measurements by level as of December 31, 2015, for the Company's financial liabilities measured at fair value on a recurring basis:

	Level 1	Level 2	Level 3
Interest rate swap agreement	$ -	$ 27	$ -
Class A warrant liability	$ -	$ 100	$ -

The following table summarizes fair value measurements by level as of September 30, 2015, for the Company's financial liabilities measured at fair value on a recurring basis:

	Level 1	Level 2	Level 3
Interest rate swap agreement	$ -	$ 50	$ -
Class A warrant liability	$ -	$ 189	$ -

[Remainder of page intentionally left blank.]

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

This report contains statements that constitute forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Those statements appear in a number of places in this Report and may include, but are not limited to, statements regarding our intent, belief or current expectations with respect to (i) our strategic plans; (ii) trends in the demand for our products and services; (iii) trends in the industries that consume our products and services; (iv) our ability to develop new products and services; (v) our ability to make capital expenditures and finance operations; (vi) global economic conditions, especially as they impact our markets; (vii) our cash position; (viii) our ability to integrate a new sales and marketing team; (ix) our ability to service our outstanding indebtedness and (x) our expectations regarding the volume of new bookings, pricing, gross profit margins and liquidity. Readers are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Actual results may differ materially from those in the forward looking statements as a result of various factors, many of which are beyond our control.

In addition, we have based these forward-looking statements on our current expectations and projections about future events. Although we believe that the assumptions on which the forward-looking statements contained herein are based are reasonable, actual events may differ from those assumptions, and as a result, the forward-looking statements based upon those assumptions may not accurately project future events. The following discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto included or incorporated by reference elsewhere in this Report. In addition to the historical information contained herein, the discussions in this Report may contain forward-looking statements that may be affected by risks and uncertainties, including those discussed in Item 1A, Risk Factors contained in our annual report on Form 10-K for the fiscal year ended September 30, 2015. Our actual results could differ materially from those discussed in the forward-looking statements.

The following amounts are in thousands, unless otherwise indicated.

Recent Events

Credit Facility

On May 14, 2014, we entered into a Credit Agreement (“Agreement”) with Huntington Bank. The Agreement includes both a term loan and a revolving loan and is secured by mortgages on our facilities in West Lafayette and Evansville, Indiana and liens on our personal property. As of December 31, 2015, we were not in compliance with certain financial covenants of the Agreement. Huntington Bank has advised us that the failure to meet these financial covenants constitutes an event of default under the Agreement and has reserved all of its rights with respect thereto, but has not exercised available remedies to date. These remedies include the ability to accelerate the outstanding debt under our term loan and revolving loan, to exercise their security interest and collect on the underlying collateral, to refrain from making additional advances under the revolving loan and to terminate our interest rate swap. Were Huntington Bank to accelerate the outstanding debt, we would have insufficient funds to satisfy that obligation, and their exercise of alternative remedies could also have a material adverse effect on our operations and financial condition.

Management is in discussion with Huntington Bank to secure a forbearance whereby Huntington Bank would agree for a limited time period to forbear from exercising certain of its rights and remedies under the Agreement, including the right to declare outstanding indebtedness thereunder immediately due. A forbearance agreement would provide management with additional time to engage in discussions with Huntington Bank and other parties regarding restructuring or replacing our debt, including amounts outstanding under the revolving loan scheduled to mature in May 2016, and to explore alternative liquidity solutions. There can be no assurance that we will be able to complete initiatives to resolve our credit issues on satisfactory terms, or at all. If we are unable to negotiate a forbearance and execute on initiatives to refinance our indebtedness or otherwise rectify our liquidity issues, we may have insufficient funds to satisfy our debt obligations and operate our business.

Business Overview

We are an international contract research organization providing drug discovery and development services. Our clients and partners include pharmaceutical, biotechnology, academic and governmental organizations. We apply innovative technologies and products and a commitment to quality to help clients and partners accelerate the development of safe and effective therapeutics and maximize the returns on their research and development investments. We offer an efficient, variable-cost alternative to our clients' internal product development programs. Outsourcing development work to reduce overhead and speed drug approvals through the Food and Drug Administration ("FDA") is an established alternative to in-house development among pharmaceutical companies. We derive our revenues from sales of our research services and drug development tools, both of which are focused on determining drug safety and efficacy. The Company has been involved in the research of drugs to treat numerous therapeutic areas for over 40 years.

We support the preclinical and clinical development needs of researchers and clinicians for small molecule and large biomolecule drug candidates. We believe our scientists have the skills in analytical instrumentation development, chemistry, computer software development, physiology, medicine, analytical chemistry and toxicology to make the services and products we provide increasingly valuable to our current and potential clients. Our principal clients are scientists engaged in analytical chemistry, drug safety evaluation, clinical trials, drug metabolism studies, pharmacokinetics and basic research at many of the small start-up biotechnology companies and the largest global pharmaceutical companies.

Our business is largely dependent on the level of pharmaceutical and biotechnology companies' efforts in new drug discovery and approval. Our services segment is a direct beneficiary of these efforts, through outsourcing by these companies of research work. Our products segment is an indirect beneficiary of these efforts, as increased drug development leads to capital expansion, providing opportunities to sell the equipment we produce and the consumable supplies we provide that support our products.

Developments within the industries we serve have a direct, and sometimes material, impact on our operations. Currently, many large pharmaceutical companies have major "block-buster" drugs that are nearing the end of their patent protections. This puts significant pressure on these companies both to develop new drugs with large market appeal, and to re-evaluate their cost structures and the time-to-market of their products. Contract research organizations ("CRO's") have benefited from these developments, as the pharmaceutical industry has turned to out-sourcing to both reduce fixed costs and to increase the speed of research and data development necessary for new drug applications. The number of significant drugs that have reached or are nearing the end of their patent protection has also benefited the generic drug industry. Generic drug companies provide a significant source of new business for CROs as they develop, test and manufacture their generic compounds.

We also believe that the development of innovative new drugs is going through an evolution, evidenced by the significant reduction of expenditures on research and development at several major international pharmaceutical companies, accompanied by increases in outsourcing and investments in smaller start-up companies that are performing the early development work on new compounds. Many of these smaller companies are funded by either venture capital or pharmaceutical investment, or both, and generally do not build internal staffs that possess the extensive scientific and regulatory capabilities to perform the various activities necessary to progress a drug candidate to the filing of an Investigative New Drug application with the FDA.

A significant portion of innovation in the pharmaceutical industry is now being driven by biotech and small, venture capital funded, drug development companies. Many of these companies are "single-molecule" entities, whose success depends on one innovative compound. While several of the biotech companies have reached the status of major pharmaceuticals, the industry is still characterized by smaller entities. These developmental companies generally do not have the resources to perform much of the research within their organizations, and are therefore dependent on the CRO industry for both their research and for guidance in preparing their FDA submissions. These companies have provided significant new opportunities for the CRO industry, including us. They do, however, provide challenges in selling, as they frequently have only one product in development, which causes CROs to be unable to develop a flow of projects from a single company. These companies may expend all their available funds and cease operations prior to fully developing a product. Additionally, the funding of these companies is subject to investment market fluctuations, which changes as the risk profiles and appetite of investors change.

While continuing to maintain and develop our relationships with large pharmaceutical companies, we intend to aggressively promote our services to developing businesses, which will require us to expand our existing capabilities to provide services early in the drug development process, and to consult with customers on regulatory strategy and compliance leading to their FDA filings. Our Enhanced Drug Discovery services, part of this strategy, utilizes our proprietary *Culex*® technology to provide early experiments in our laboratories that previously would have been conducted in the sponsor’s facilities. As we move forward, we must balance the demands of the large pharmaceutical companies with the personal touch needed by smaller biotechnology companies to develop a competitive advantage. We intend to accomplish this through the use of and expanding upon our existing project management skills, strategic partnerships and relationship management.

Research services are capital intensive. The investment in equipment and facilities to serve our markets is substantial and continuing. While our physical facilities are adequate to meet market needs for the near term, rapid changes in automation, precision, speed and technologies necessitate a constant investment in equipment and software to meet market demands. We are also impacted by the heightened regulatory environment and the need to improve our business infrastructure to support our increasingly diverse operations, which will necessitate additional capital investment. Our ability to generate capital to reinvest in our capabilities, both through operations and financial transactions, is critical to our success. While we are currently committed to fully utilizing recent additions to capacity, sustained growth will require additional investment in future periods. Our financial position could limit our ability to make such investments.

Executive Summary

As noted above, Huntington Bank has advised us that the failure to meet financial covenants pertaining to our credit facility constitutes an event of default under the Agreement and has reserved all of its rights with respect thereto. Although Huntington Bank has not exercised its available remedies to date, these circumstances raise substantial doubt about the Company's ability to continue as a going concern, and management has and will continue to take measures to mitigate that possibility.

The Company is engaged in exploring initiatives to address solutions to our credit issues, which includes the evaluation and pursuit of various sources of financing. Management is also undergoing a detailed review of all current pricing strategies and market programs and has begun new initiatives designed to increase revenue. Lastly, management has been, and continues to be actively engaged in driving operating costs lower by more effectively controlling operating costs and manpower costs.

Management is in discussion with Huntington Bank to secure a forbearance whereby Huntington Bank would agree for a limited time period to forbear from exercising certain of their rights and remedies under the credit facility available to Huntington as a result of the non-compliance. A forbearance agreement would provide management with additional time to engage in discussions with Huntington Bank and other parties regarding restructuring or replacing our debt, including amounts outstanding under the revolving loan scheduled to mature in May 2016, and to explore alternative liquidity solutions.

Our revenues are dependent on a relatively small number of industries and customers. As a result, we closely monitor the market for our services and products. In the first three months of fiscal 2016, we experienced a 7.8% decrease in revenues in our Services segment and a 41.9% decrease in revenues for our Products segment as compared to the first three months of fiscal 2015. Our Services revenue was negatively impacted by fewer bioequivalence studies and a mix shift favoring method development and validation projects in the first three months of fiscal 2016 versus the comparable period of fiscal 2015. These negative factors were partially offset by an increase in our preclinical services revenue in the first quarter of fiscal 2016. The revenue decline in our Products segment was mainly due to lower sales of our analytical instruments and lower sales of instruments in our *Culex*®, *in vivo* sampling product line as compared to the prior fiscal year.

We review various metrics to evaluate our financial performance, including revenue, margins and earnings. Revenues decreased approximately 16.3% and gross margin decreased 48.3% in the first quarter of fiscal 2016 from the prior year period. Operating expenses decreased 14.1% in the first quarter of fiscal 2016 from the first quarter of fiscal 2015 due in large part to the building lease agreement described below and reduced utilities. The lower margins contributed to the reported operating loss of $529 for the first fiscal quarter of 2016 compared to operating income of $142 for the prior year period. For a detailed discussion of our revenue, margins, earnings and other financial results for the three months ended December 31, 2015, see “Results of Operations” below.

As of December 31, 2015, we had $403 of cash and cash equivalents as compared to $438 of cash and cash equivalents at the end of fiscal 2015. In the first quarter of fiscal 2016, we used $348 in cash from operations, partially due to the lower operating income we reported in the first quarter of fiscal 2016 and utilized $738 in additional borrowings on our line of credit. Total capital expenditures were $166 in the first quarter of fiscal 2016, up from $122 in the first quarter of fiscal 2015.

In January 2015, we entered into a lease agreement with an initial term of approximately nine years and 11 months for 50,730 square feet of office, manufacturing and warehouse space located at the Company’s headquarters to monetize underutilized space. We do not believe the lease will materially impact the Company’s business or service capabilities over the foreseeable future. The lease agreement has provided and will provide the Company with additional cash in the range of approximately $50 per month during the first year of the initial term to approximately $57 per month during the final year of the initial term, however Huntington Bank may require Cook Biotech to make future rental payments directly to Huntington Bank as a result of the company’s non-compliance with financial covenants pertaining to our credit facility.

Results of Operations

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

	Three Months Ended December 31, 2015	2014
Service revenue	82.8 %	75.2 %
Product revenue	17.2	24.8
Total revenue	100.0	100.0
Cost of service revenue ***(a)***	82.3	74.0
Cost of product revenue ***(a)***	68.2	47.3
Total cost of revenue	79.9	67.4
Gross profit	20.1	32.6
Total operating expenses	30.9	30.1
Operating income (loss)	(10.8)	2.5
Other benefit (expense)	0.5	0.7
Income (loss) before income taxes	(10.3)	3.2
Income taxes	—	—
Net income (loss)	(10.3)%	3.2 %

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

Three Months Ended December 31, 2015 Compared to Three Months Ended December 31, 2014

Service and Product Revenues

Revenues for the fiscal quarter ended December 31, 2015 decreased 16.3% to $4,895 compared to $5,845 for the same period last year.

Our Service revenue decreased 7.8% to $4,055 in the first quarter of fiscal 2016 compared to $4,398 for the prior year period. Preclinical services revenues slightly increased due to an increase in the number of dog and rat studies from the prior year period. Other laboratory services revenues were negatively impacted by lower pharmaceutical analysis revenues due to fewer bioequivalence studies in the first three months of fiscal 2016 versus the comparable period in fiscal 2015. Bioanalytical analysis revenues declined due to fewer samples received and analyzed in the first quarter of fiscal 2016 and a mix favoring method development and validation projects during that time period, which generate lower revenue but involve more dedicated resources.

	Three Months Ended December 31,			
	2015	2014	Change	%
Bioanalytical analysis	1,438	1,733	$ (295)	-17.0%
Preclinical services	2,500	2,351	149	6.3 %
Other laboratory services	117	314	(197)	-62.7%

Sales in our Products segment decreased 41.9% in the first quarter of fiscal 2016 from $1,447 to $840 when compared to the same period in the prior fiscal year. The majority of the decrease stems from lower sales of our Culex automated *in vivo* sampling systems and analytical instruments over the same period in the prior fiscal year.

	Three Months Ended December 31,			
	2015	2014	Change	%
Culex, in-vivo sampling systems	$ 302	$ 779	$ (477)	-61.2%
Analytical instruments	346	517	(171)	-33.1%
Other instruments	192	151	41	27.2 %

Cost of Revenues

Cost of revenues for the first quarter of fiscal 2016 was $3,911 or 79.9% of revenue, compared to $3,940, or 67.4% of revenue for the prior year period.

Cost of Service revenue as a percentage of Service revenue increased to 82.3% during the first quarter of fiscal 2016 from 74.0% in the comparable period last year. The principal cause of this increase was the decrease in revenues, which led to lower absorption of the fixed costs in our Service segment. A significant portion of our costs of productive capacity in the Service segment are fixed. Thus, decreases in revenues lead to increases in costs as a percentage of revenue.

Costs of Products revenue as a percentage of Product revenue in the first quarter of fiscal 2016 increased to 68.2% from 47.3% in the comparable prior year period. This increase is mainly due to a change in the mix of products sold as well as costs incurred related to the design and implementation of lean initiatives in the first three months of fiscal 2016.

Operating Expenses

Selling expenses for the three months ended December 31, 2015 decreased 8.6% to $307 from $336 for the comparable period last year. This decrease is mainly due to decreased commissions in the first fiscal quarter of 2016 compared to the same period in fiscal 2015, partially offset by increased spending for promotional and consulting services.

Research and development expenses for the first quarter of fiscal 2016 decreased 17.8% over the comparable period last year to $157 from $191. The decrease was primarily due to lower utilization of outsourced professional engineering services.

General and administrative expenses for the first quarter of fiscal 2016 decreased 15.1% to $1,049 from $1,235 for the comparable prior year period. The principal reason for the decrease was the building rental income of $159, which was deducted from general and administrative expense, as well as decreased utilities and bonus expense partially offset by increased recruiting costs in the first quarter of fiscal 2016.

Other Income (Expense)

Other income for the first quarter of fiscal 2016 decreased to $24 from $41 for the same quarter of the prior fiscal year. The primary reason for the decrease is the change in the fair value of the warrant liability as well as a decrease in interest expense.

Income Taxes

Our effective tax rate for the quarters ended December 31, 2015 and 2014 was (0.2)% and 0.4%, respectively. The current year expense primarily relates to state income tax.

Restructuring Activities

In March 2012, we announced a plan to restructure our bioanalytical laboratory operations. We consolidated our laboratory in McMinnville, Oregon into our 120,000 square foot headquarters facility in West Lafayette, Indiana and closed our facility and bioanalytical laboratory in Warwickshire, United Kingdom. We continue to sell our products globally while further consolidating delivery of our CRO services into our Indiana locations.

We reserved for lease payments at the cease use date for our UK facility and have considered free rent, sublease rentals and the number of days it would take to restore the space to its original condition prior to our improvements. In the first quarter of fiscal 2013, we began amortizing into general and administrative expense, equally through the cease use date, the estimated rent income of $200 when the reserve was originally established. In the first quarter of fiscal 2015, we recorded $20 of the estimated rent income as expense. We have been unsuccessful at subleasing the facility. Based on these matters, we have $1,000 reserved for UK lease related costs at December 31, 2015. We do not expect to accrue additional amounts in fiscal 2016. We have previously communicated with the landlord regarding the nature and timing of rent under the lease. The full restructuring reserve is classified in other accounts payable on the Consolidated Balance Sheets because the full amount is due and payable. The UK building lease expires in 2023 but includes an opt out provision after 7 years, which occurred in the fourth quarter of fiscal 2015 and was exercised.

Other costs of $117 have been accrued for legal and professional fees and other costs estimated to be incurred in connection with transitioning services from sites being closed as well as costs incurred to remove improvements previously made to the UK facility. In fiscal 2015, all related investments in the UK operations were removed domestically.

Liquidity and Capital Resources

Recent Events

Please refer to the discussion above under “Recent Events” – “Credit Facility” regarding non-compliance with certain financial covenants of our credit facility. Please also refer to the disclosure under “ITEM 1A - RISK FACTORS” herein.

Comparative Cash Flow Analysis

At December 31, 2015, we had cash and cash equivalents of $403, compared to $438 at September 30, 2015.

Net cash used in operating activities was $348 for the three months ended December 31, 2015 compared to cash used in operating activities of $161 for the three months ended December 31, 2014. The increase in cash used by operating activities in the first quarter of fiscal 2016 partially resulted from lower operating income versus the prior year period. Other contributing factors to our cash used in operations in the first quarter of fiscal 2016 were noncash charges of $342 for depreciation and amortization and a net decrease in accounts receivable of $1,474 and in prepaid expenses of $351. These were offset by a net decrease in accounts payable of $499, a decrease in accrued expenses of $728 and a decrease in customer advances of $690.

Days' sales in accounts receivable decreased to 47 days at December 31, 2015 from 73 days at September 30, 2015 due to improved collections from certain customers and a decrease in unbilled revenues**.** It is not unusual to see a fluctuation in the Company's pattern of days' sales in accounts receivable. Customers may expedite or delay payments from period-to-period for a variety of reasons including, but not limited to, the timing of capital raised to fund on-going research and development projects.

Included in operating activities for the first fiscal quarter of 2015 are non-cash charges of $377 for depreciation and amortization and an increase in accounts payable of $228 offset slightly by an increase in accounts receivable of $355 and a decrease in accrued expenses of $498.

Investing activities used $166 in the first quarter of fiscal 2016 due to capital expenditures as compared to $122 in the first three months of fiscal 2015. The investing activity in fiscal 2016 consisted of investments in computing infrastructure, building improvements and other capital improvements as well as equipment. The increase in capital expenditures in fiscal 2016 reflects the investments being made to support our growth initiatives as well as the investments to relocate our manufacturing and update our office and meeting space following the lease executed with Cook Biotech in fiscal 2015.

Financing activities provided $479 in the first three months of fiscal 2016 as compared to $7 provided for the first three months of fiscal 2015. The main source of cash in the first quarter of fiscal 2016 was net borrowings on our line of credit of $738, offset partially by long-term debt and capital lease payments of $263. In the first quarter of fiscal 2015, we had long-term debt and capital lease payments of $271, as well as net borrowings on our line of credit of $278.

Capital Resources

Credit Facility

On May 14, 2014, we entered into a Credit Agreement ("Agreement") with Huntington Bank. The Agreement includes both a term loan and a revolving loan and is secured by mortgages on our facilities in West Lafayette and Evansville, Indiana and liens on our personal property. As of December 31, 2015, we were not in compliance with certain financial covenants of the Agreement. Huntington Bank has advised us that the failure to meet these financial covenants constitutes an event of default under the Agreement and has reserved all of its rights with respect thereto, but has not exercised available remedies to date. These remedies include the ability to accelerate the outstanding debt under our term loan and revolving loan, to exercise their security interest and collect on the underlying collateral, to refrain from making additional advances under the revolving loan and to terminate our interest rate swap. Were Huntington Bank to accelerate the outstanding debt, we would have insufficient funds to satisfy that obligation, and their exercise of alternative remedies could also have a material adverse effect on our operations and financial condition.

Management is in discussion with Huntington Bank to secure a forbearance whereby Huntington Bank would agree for a limited time period to forbear from exercising certain of its rights and remedies under the Agreement, including the right to declare outstanding indebtedness thereunder immediately due. A forbearance agreement would provide management with additional time to engage in discussions with Huntington Bank and other parties regarding restructuring or replacing our debt, including amounts outstanding under the revolving loan scheduled to mature in May 2016, and to explore alternative liquidity solutions. There can be no assurance that we will be able to complete initiatives to resolve our credit issues on satisfactory terms, or at all. If we are unable to negotiate a forbearance and execute on initiatives to refinance our indebtedness or otherwise rectify our liquidity issues, we may have insufficient funds to satisfy our debt obligations and operate our business.

The term loan for $5,500 bears interest at LIBOR plus 325 basis points with monthly principal payments of approximately $65 plus interest. The term loan matures in May 2019. On May 15, 2014, we used the proceeds from the term loan to pay off prior indebtedness. The balance on the term loan at December 31, 2015 and September 30, 2015 was $4,256 and $4,452, respectively.

The revolving loan for $2,000 matures in May 2016 and bears interest at LIBOR plus 300 basis points with interest paid monthly. The revolving loan also carries a facility fee of .25%, paid quarterly, for the unused portion of the revolving loan. The revolving loan includes an annual clean-up provision that requires the Company to maintain a balance of not more than 20% of the maximum loan of $2,000 for a period of 30 days in any 12 month period while the revolving loan is outstanding. The revolving loan balance was $824 and $ 86 at December 31, 2015 and September 30, 2015, respectively.

On May 14, 2015, we executed a first amendment to the Agreement with Huntington Bank. As amended, the Agreement requires us to maintain a fixed charge coverage ratio of not less than 1.05 to 1.00 for the fiscal quarters ending June 30, 2015, September 30, 2015 and December 31, 2015 and not less than 1.10 to 1.00 for the fiscal quarter ending March 31, 2016 until maturity. The fixed charge coverage ratio calculation excludes up to $1,000 in capital expenditures related to the building renovation costs associated with our lease agreement with Cook Biotech, Inc. executed in January 2015. The Agreement also requires us to maintain a maximum total leverage ratio of not greater than 3.00 to 1.00 from the date of the Agreement through September 30, 2015 and 2.50 to 1.00 commencing after October 1, 2015 until maturity. The Agreement also contains various other covenants, including restrictions on the incurrence of certain indebtedness, liens, investments, acquisitions, asset sales and cash dividends. As of December 31, 2015, we were not in compliance with the fixed charge coverage ratio and maximum total leverage ratio.

Upon and during the occurrence of an event of default, at the election of Huntington Bank and after notice to the Company, all interest accruing in respect of obligations of the Company under the Agreement may be increased by a per annum percentage equal to five percent (5%) over the otherwise applicable rate.

We entered into an interest rate swap agreement with respect to the above loans to fix the interest rate with respect to 60% of the value of the term loan at approximately 5.0%. We entered into this derivative transaction to hedge interest rate risk of the related debt obligation and not to speculate on interest rates. The changes in the fair value of the interest rate swap are recorded in AOCI to the extent effective. We assess on an ongoing basis whether the derivative that is used in the hedging transaction is highly effective in offsetting changes in cash flows of the hedged debt. The terms of the interest rate swaps match the terms of the underlying debt resulting in no ineffectiveness.

The Company is fully engaged in exploring alternatives to address solutions to our liquidity issues. However, if we are unable to negotiate a forbearance with Huntington Bank and execute on initiatives to refinance our indebtedness or otherwise rectify our liquidity issues, we may have insufficient funds to both satisfy our debt obligations as they become due and operate our business.

Critical Accounting Policies

"Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Liquidity and Capital Resources" discuss the unaudited condensed consolidated financial statements of the Company, which have been prepared in accordance with accounting principles generally accepted in the United States. Preparation of these financial statements requires management to make judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosures of contingent assets and liabilities. Certain significant accounting policies applied in the preparation of the financial statements require management to make difficult, subjective or complex judgments, and are considered critical accounting policies. We have identified the following areas as critical accounting policies.

Revenue Recognition

The majority of our Bioanalytical and analytical research service contracts involve the development of analytical methods and the processing of bioanalytical samples for pharmaceutical companies and generally provide for a fixed fee for each sample processed. Revenue is recognized under the specific performance method of accounting and the related direct costs are recognized when services are performed. Our preclinical research service contracts generally consist of preclinical studies, and revenue is recognized under the proportional performance method of accounting. Revisions in profit estimates, if any, are reflected on a cumulative basis in the period in which such revisions become known. The establishment of contract prices and total contract costs involves estimates we make at the inception of the contract. These estimates could change during the term of the contract and impact the revenue and costs reported in the consolidated financial statements. Revisions to estimates have generally not been material. Research service contract fees received upon acceptance are deferred until earned, and classified within customer advances. Unbilled revenues represent revenues earned under contracts in advance of billings.

Product revenue from sales of equipment not requiring installation, testing or training is recognized upon shipment to customers. One product includes internally developed software and requires installation, testing and training, which occur concurrently. Revenue from these sales is recognized upon completion of the installation, testing and training when the services are bundled with the equipment sale.

Long-Lived Assets, Including Goodwill

Long-lived assets, such as property and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

We carry goodwill at cost. Other intangible assets with definite lives are stated at cost and are amortized on a straight-line basis over their estimated useful lives. All intangible assets acquired that are obtained through contractual or legal right, or are capable of being separately sold, transferred, licensed, rented, or exchanged, are recognized as an asset apart from goodwill. Goodwill is not amortized.

Goodwill is tested annually for impairment and more frequently if events and circumstances indicate that the asset might be impaired. First, we can assess qualitative factors in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Then, we follow a two-step quantitative process. In the first step, we compare the fair value of each reporting unit, as computed primarily by present value cash flow calculations, to its book carrying value, including goodwill. We do not believe that market value is indicative of the true fair value of the Company mainly due to average daily trading volumes of less than 1%. If the fair value exceeds the carrying value, no further work is required and no impairment loss is recognized. If the carrying value exceeds the fair value, the goodwill of the reporting unit is potentially impaired and we would then complete step 2 in order to measure the impairment loss. In step 2, the implied fair value is compared to the carrying amount of the goodwill. If the implied fair value of goodwill is less than the carrying value of goodwill, we would recognize an impairment loss equal to the difference. The implied fair value is calculated by allocating the fair value of the reporting unit (as determined in step 1) to all of its assets and liabilities (including unrecognized intangible assets) and any excess in fair value that is not assigned to the assets and liabilities is the implied fair value of goodwill.

The discount rate, gross margin and sales growth rates are the two material assumptions utilized in our calculations of the present value cash flows used to estimate the fair value of the reporting units when performing the annual goodwill impairment test. Our reporting units with goodwill at December 31, 2015 are bioanalytical services and preclinical services, which are both included in our Services segment, based on the discrete financial information available which is reviewed by management. We utilize a cash flow approach in estimating the fair value of the reporting units, where the discount rate reflects a weighted average cost of capital rate. The cash flow model used to derive fair value is sensitive to the discount rate and sales growth assumptions used.

Considerable management judgment is necessary to evaluate the impact of operating and macroeconomic changes and to estimate future cash flows. Assumptions used in our impairment evaluations, such as forecasted sales growth rates and our cost of capital or discount rate, are based on the best available market information. Changes in these estimates or a continued decline in general economic conditions could change our conclusion regarding an impairment of goodwill and potentially result in a non-cash impairment loss in a future period. The assumptions used in our impairment testing could be adversely affected by certain of the risks discussed in “Risk Factors” in Item 1A contained herein and in our 10-K for the fiscal year ended September 30, 2015. There have been no significant events since the timing of our impairment tests that have triggered additional impairment testing. At December 31, 2015, remaining recorded goodwill was $1,009.

Stock-Based Compensation

We recognize the cost resulting from all share-based payment transactions in our financial statements using a fair-value-based method. We measure compensation cost for all share-based awards based on estimated fair values and recognize compensation over the vesting period for awards. We recognized stock-based compensation related to stock options of $15 and $29 during the three months ended December 31, 2015 and 2014, respectively.

We use the binomial option valuation model to determine the grant date fair value. The determination of fair value is affected by our stock price as well as assumptions regarding subjective and complex variables such as expected employee exercise behavior and our expected stock price volatility over the term of the award. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes. We estimated the following key assumptions for the binomial valuation calculation:

- *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 volatility.* We use our historical stock price volatility on our common stock for our expected volatility assumption.
- *Expected term.* The expected term represents the weighted-average period the stock options are expected to remain outstanding. The expected term is determined based on historical exercise behavior, post-vesting termination patterns, options outstanding and future expected exercise behavior.
- *Expected dividends.* We assumed that we will pay no dividends.

Employee stock-based compensation expense recognized in the first three months of fiscal 2016 and 2015 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. Forfeitures are revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates and an adjustment will be recognized at that time.

Changes to our underlying stock price, our assumptions used in the binomial option valuation calculation and our forfeiture rate as well as future grants of equity could significantly impact compensation expense to be recognized in fiscal 2016 and future periods.

Income Taxes

As described in Note 6 to the condensed consolidated financial statements, we use the asset and liability method of accounting for income taxes. We recognize deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. We measure deferred tax assets and liabilities 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. We recognize the effect on deferred tax assets and liabilities of a change in tax rates in income in the period that includes the enactment date. We record valuation allowances based on a determination of the expected realization of tax assets.

We recognize the tax benefit from an uncertain tax position only if it is more likely than not to be sustained upon examination based on the technical merits of the position. We measure the amount of the accrual for which an exposure exists as the largest amount of benefit determined on a cumulative probability basis that we believe is more likely than not to be realized upon ultimate settlement of the position.

We record interest and penalties accrued in relation to uncertain income tax positions as a component of income tax expense. Any changes in the accrued liability for uncertain tax positions would impact our effective tax rate. Over the next twelve months we do not anticipate changes to the carrying value of our reserve. Interest and penalties are included in the reserve.

As of December 31, 2015 and September 30, 2015, we had a $16 liability for uncertain income tax positions.

We file income tax returns in the U.S. and several U.S. states. We remain subject to examination by taxing authorities in the jurisdictions in which we have filed returns for years after 2010.

We have an accumulated net deficit in our UK subsidiary. With the closure of the UK facility, we no longer have any filing obligations in the UK. Consequently, the related deferred tax asset on such losses and related valuation allowance on the UK subsidiary have been removed.

Inventories

Inventories are stated at the lower of cost or market using the first-in, first-out (FIFO) cost method of accounting. We evaluate inventories on a regular basis to identify inventory on hand that may be obsolete or in excess of current and future projected market demand. For inventory deemed to be obsolete, we provide a reserve for this inventory. Inventory that is in excess of current and projected use is reduced by an allowance to a level that approximates the estimate of future demand.

Fair Value of Warrant Liability

In May 2011, we issued Class A and B Warrants that are measured at fair value on a recurring basis. We recorded these warrants as a liability determining the fair value at inception on May 11, 2011. Subsequent quarterly fair value measurements, using the Black Scholes model which is considered a level 2 fair value measurement, are calculated with fair value changes charged to the statement of operations and comprehensive income (loss). Class B Warrants expired in May 2012 and the liability was reduced to zero. As of December 31, 2015, 578 Class A warrants have been exercised, leaving 799 outstanding. The fair value of the warrants exercised was $854. The following table sets forth the changes in the fair value of the warrant liability since inception:

Evaluation Date	Fair Value per Share		Fair Value in $$			Change in Fair Value
	Warrant A	Warrant B	Warrant A	Warrant B	Total	(Income) Expense
5/11/2011	$ 1.433	$ 0.779	$ 1,973	$ 1,072	$ 3,045	$ -
6/30/2011	1.536	0.811	2,114	1,116	3,230	185
9/30/2011	0.844	0.091	1,162	124	1,286	(1,944)
12/30/2011	0.901	0.074	1,240	102	1,342	56
3/30/2012	0.933	0.001	1,284	2	1,286	(56)
6/29/2012	0.602	-	828	-	828	(458)
9/28/2012	0.881	-	1,213	-	1,213	385
12/31/2012	0.796	-	1,096	-	1,096	(117)
3/28/2013	0.899	-	1,238	-	1,238	142
6/28/2013	0.668	-	920	-	920	(318)
9/30/2013	0.444	-	612	-	612	(308)
12/31/2013	1.396	-	1,573	-	1,573	961
3/31/2014	1.152	-	934	-	934	200
6/30/2014	1.067	-	852	-	852	(66)
9/30/2014	0.846	-	676	-	676	(160)
12/31/2014	0.696	-	556	-	556	(120)
3/31/2015	0.447	-	357	-	357	(199)
6/30/2015	0.404	-	323	-	323	(34)
9/30/2015	0.236	-	189	-	189	(134)
12/31/2015	0.124	-	100	-	100	(89)

Interest Rate Swap

The Company uses an interest rate swap designated as a cash flow hedge to fix the interest rate on 60% of the Huntington debt due to changes in interest rates. The changes in the fair value of the interest rate swap are recorded in Accumulated Other Comprehensive Income (“AOCI”) to the extent effective. We assess on an ongoing basis whether the derivative that is used in the hedging transaction is highly effective in offsetting changes in cash flows of the hedged debt. The terms of the interest rate swaps match the terms of the underlying debt resulting in no ineffectiveness. When we determine that a derivative is not highly effective as a hedge, hedge accounting is discontinued and we reclassify gains or losses that were accumulated in AOCI to other income (expense), net on the Condensed Consolidated Statements of Operations and Comprehensive Income (Loss).

Building Lease

The Lease Agreement with Cook Biotech, Inc. for a portion of the Company’s headquarters facility is recorded as an operating lease with the escalating rents being recognized on a straight-line basis once the Tenant took full possession of the space on May 1, 2015 through the end of the lease on December 31, 2024. The straight line rents of $53 per month are recorded as a reduction to general and administrative expenses on the Consolidated Statements of Operations and Comprehensive Income (Loss) and other accounts receivable on the Consolidated Balance Sheets. The cash rent received is recorded in other accounts receivable on the Consolidated Balance Sheets. The variance between the straight line rents recognized and the actual cash rents received will net to zero by the end of the agreement on December 31, 2024.

New Accounting Pronouncements

Effective October 1, 2018, the Company will be required to adopt the new guidance of ASC Topic 606, *Revenue from Contracts with Customers* (Topic 606), which will supersede the revenue recognition requirements in ASC Topic 605, *Revenue Recognition*. Topic 606 requires the Company to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new guidance requires the Company to apply the following steps: (1) identify the contract with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the Company satisfies a performance obligation. The Company will be required to adopt Topic 606 either on a full retrospective basis to each prior reporting period presented or on a modified retrospective basis with the cumulative effect of initially applying the new guidance recognized at the date of initial application. If the Company elects the modified retrospective approach, it will be required to provide additional disclosures of the amount by which each financial statement line item is affected in the current reporting period, as compared to the guidance that was in effect before the change, and an explanation of the reasons for significant changes. The Company has not yet assessed the impact of the new guidance on its consolidated financial statements.

In August 2014, the FASB issued new guidance in Accounting Standards Update (ASU) No. 2014-15, "Presentation of Financial Statements – Going Concern (Subtopic 205-40)." The update provides guidance regarding management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The Company is required to adopt the guidance in the first quarter of fiscal 2017. We are currently evaluating the impact that this guidance will have on our consolidated financial statements.

In November 2014, the FASB issued new guidance in ASU No. 2014-16, "Derivatives and Hedging (Topic 815) – Determining whether the host contract in a hybrid financial instrument issued in the form of a share is more akin to debt or to equity." The guidance clarifies how current GAAP should be interpreted in subjectively evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. The Company is required to adopt the guidance in the first quarter of fiscal 2017. We are currently evaluating the impact that this guidance will have on our consolidated financial statements.

In February 2015, the FASB amended guidance in ASU No. 2015-02, "Consolidation Topic 810." The guidance made certain targeted revisions to various area of the consolidation guidance, including the determination of the primary beneficiary of an entity, among others. The Company is required to adopt the guidance in the first quarter of fiscal 2017. We are currently evaluating the impact that this guidance will have on our consolidated financial statements.

In April 2015, the FASB amended the existing accounting standards for imputation of interest. The amendments require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by these amendments. The Company is required to adopt the guidance in the first quarter of fiscal 2017. Early adoption is permitted. The amendments should be applied retrospectively with the adjusted balance sheet of each individual period presented, in order to reflect the period-specific effects of applying the new guidance. The Company is currently evaluating the timing and the impact of these amendments on its consolidated financial statements.

In July 2015, the FASB issued an amendment to the accounting guidance related to the measurement of inventory. The amendment revises inventory to be measured at lower of cost and net realizable value from lower of cost or market. Subsequent measurement is unchanged for inventory measured using last-in, first-out (LIFO) or the retail inventory method. This guidance will be effective prospectively for the first quarter of fiscal 2018, with early application permitted. We are currently evaluating the impact that this guidance will have on our consolidated financial statements.

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

A smaller reporting company is not required to provide the information required by this Item 3.

ITEM 4 - CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to provide reasonable assurance to our management and board of directors that information required to be disclosed in the reports we file or submit to the Securities and Exchange Commission is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Based on an evaluation conducted under the supervision and with the participation of the Company’s management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2015, we, including our Chief Executive Officer and Chief Financial Officer, determined that those controls and procedures were effective as of December 31, 2015.

Changes in Internal Controls

There were no changes in our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, during the first three months of fiscal 2016 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II

ITEM 1A - RISK FACTORS

In addition to the risks described below, before investing in our securities you should carefully consider the risks described in our Annual Report on Form 10-K for the year ended September 30, 2015, including those under the heading “Risk Factors” appearing in Item 1A of Part I of the Form 10-K, as well as other information contained in this Quarterly Report. Realization of any of these risks could have a material adverse effect on our business, financial condition, cash flows and results of operations.

We are currently in default of certain covenants pertaining to our credit facility, which could have a material adverse effect on our operations.

Our credit facility with Huntington Bank requires us to satisfy certain operating requirements and financial ratios in order to avoid a default or event of default under the agreement. These financial covenants are described above within “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” We did not satisfy our fixed charge coverage ratio and maximum total leverage ratio for the period ended December 31, 2015. Huntington Bank has advised us that the failure to meet these financial covenants constitutes an event of default under the credit facility and has reserved all of its rights with respect thereto, but has not exercised available remedies to date. These remedies include the ability to accelerate the outstanding debt under our term loan and revolving loan, to exercise their security interest and collect on the underlying collateral, to refrain from making additional advances under the revolving loan and to terminate our interest rate swap. Were Huntington Bank to accelerate the outstanding debt, we would have insufficient funds to satisfy that obligation, and their exercise of alternative remedies could also have a material adverse effect on our operations and financial condition.

Management is in discussion with Huntington Bank to secure a forbearance whereby Huntington Bank would agree for a limited time period to forbear from exercising certain of its rights and remedies under the credit facility, including the right to declare outstanding indebtedness thereunder immediately due. A forbearance agreement would likely include additional operational and financial restrictions and may result in the incurrence of additional fees. There can be no we will be able to complete initiatives to resolve our credit issues on satisfactory terms, or at all.

We may have insufficient cash to operate our business and make scheduled payments on our debt obligations.

Our credit facility requires us to make monthly principal and interest payments on our term loan and to payoff outstanding amounts on the revolving loan when it becomes due in May of 2016. If we are unable to successfully restructure or replace these obligations, we may not have sufficient cash to operate our business and make scheduled debt payments, including satisfying outstanding amounts under the revolving loan. In addition, the Company's lease arrangements with Cook Biotech provide that, in the event of a default under the Company's credit facility, Huntington Bank may require Cook Biotech to make future rental payments directly to Huntington Bank. Direct rental payments by Cook Biotech to Huntington Bank would alleviate a portion of the monthly principal and interest payments owed by the Company under its term loan. However, the cash the Company would otherwise have received from Cook Biotech would no longer be available to employ in the operation of the Company's business.

Were Huntington Bank to declare outstanding indebtedness under our Credit Facility immediately due or in the event that we are otherwise unable to satisfy our financial obligations, we may face bankruptcy or insolvency, and may lack the financing to continue operations.

Were Huntington Bank to declare outstanding indebtedness owed to it under our credit facility immediately due or if we are unable to otherwise satisfy our financial obligations as they become due, we may find it necessary to file for protection under Chapter 11 of the U.S. Bankruptcy Code, and upon any such filing we are likely to require immediate access to funding in order to continue operations. Funding for the Company in bankruptcy cannot be assured, and would be most likely in the form of debtor-in-possession financing. We may be unable to find any lender willing to provide us with debtor-in-possession financing and any such financing that we are able to obtain would require approval by the bankruptcy court. If such financing is not available, then we may find it necessary to discontinue our operations. A bankruptcy filing by us would subject our business and operations to various additional risks, including the following:

- a bankruptcy filing and operating under bankruptcy protection would involve significant costs, including expenses of legal counsel and other professional advisors;
- transactions outside the ordinary course of business would be subject to the prior approval of the bankruptcy court, which might limit our ability to respond timely to certain events or take advantage of certain opportunities;
- we might be unable to retain key executives and employees through the process of reorganization;
- we may be unable to successfully develop, prosecute, confirm, and consummate a plan of reorganization that would be acceptable to the bankruptcy court and our creditors, equity holders, and other parties in interest; and
- our common stock may cease to be listed on a national securities exchange, which would make it difficult for stockholders to sell or accurately value our common stock.

Our current credit facility difficulties could have an adverse impact on our business and increase our operating costs.

The fact that we are in default on our credit facility is likely to cause our customers and vendors to seek financial assurances from us before they are willing to continue doing business with us and they may instead choose to do business with our competitors. This may result in increased costs of our operations, thereby adversely affecting our results of operations. In addition, we may incur significant expenses in order to address our long-term credit issues,.

In the event that we are able to successfully restructure our debt, our borrowing costs may increase.

In the event that we are able to successfully restructure our debt, with Huntington Bank or otherwise, the lenders may require that we pay substantially higher interest and fees on our debt going forward. This may result in increased costs of our operations thereby adversely affecting our results of operations, and no assurance can be given that any higher interest or fees will be sustainable by us.

ITEM 6 - EXHIBITS

(a) Exhibits:

See the Exhibit Index to this Form 10-Q, which is incorporated herein by reference.

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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:

BIOANALYTICAL SYSTEMS, INC.

(Registrant)

Date:	February 16, 2016	By: /s/ Jacqueline M. Lemke Jacqueline M. Lemke President and Chief Executive Officer
Date:	February 16, 2016	By: /s/ Jeffrey Potrzebowski Jeffrey Potrzebowski Chief Financial Officer and Vice President of Finance

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EXHIBIT INDEX

Number		**Description of Exhibits**
(10)	10.1	Form of Bioanalytical Systems, Inc. Retention and Severance Agreement (incorporated by reference to Exhibit 10.1 to the Form 8-K filed November 19, 2015).
(31)	31.1	Certification of Chief Executive Officer (filed herewith).
	31.2	Certification of Chief Financial Officer (filed herewith).
(32)	32.1	Written Statement of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350) (filed herewith).
	32.2	Written Statement of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350) (filed herewith).
	101	XBRL data file (filed herewith).