ABAXIS INC
Form 10-Q
November 10, 2014

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014
or

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

Commission File Number 000-19720

ABAXIS, INC.
(Exact name of registrant as specified in its charter)

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

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

(510) 675-6500
(Registrant's telephone number including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

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

Yes o No x

As of November 6, 2014, there were 22,536,000 shares of the registrant's common stock outstanding.

ABAXIS, INC.
Form 10-Q
For the Quarter Ended September 30, 2014

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

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

	September 30, 2014	March 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$84,594	$73,589
Short-term investments	20,844	29,102
Receivables (net of allowances of $272 at September 30, 2014 and $182 at March 31, 2014)	36,351	29,227
Inventories	28,987	26,978
Prepaid expenses and other current assets	3,954	2,452
Net deferred tax assets, current	5,990	4,464
Total current assets	180,720	165,812
Long-term investments	20,851	18,491
Investment in unconsolidated affiliate	2,614	2,646
Property and equipment, net	28,884	27,176
Intangible assets, net	875	1,624
Net deferred tax assets, non-current	1,555	1,557
Other assets	131	74
Total assets	$235,630	$217,380
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$10,143	$6,111
Accrued payroll and related expenses	8,802	4,654
Accrued taxes	764	1,144
Other accrued liabilities	5,555	3,095
Deferred revenue	1,226	1,208
Warranty reserve	1,193	1,047
Total current liabilities	27,683	17,259
Non-current liabilities:		
Deferred rent	768	768
Deferred revenue	3,576	4,035
Warranty reserve	992	821
Notes payable, less current portion	531	581
Total non-current liabilities	5,867	6,205
Total liabilities	33,550	23,464
Commitments and contingencies (Note 9)		
Shareholders' equity:		
Preferred stock, no par value: 5,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock, no par value: 35,000,000 shares authorized; 22,523,000 and 22,308,000 shares issued and outstanding at September 30, 2014 and at March 31, 2014, respectively	127,163	124,603

Retained earnings	74,935	69,318
Accumulated other comprehensive loss	(18)	(5)
Total shareholders' equity	202,080	193,916
Total liabilities and shareholders' equity	$235,630	$217,380

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

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Revenues	$53,943	$45,851	$101,420	$89,020
Cost of revenues	25,511	23,979	49,116	46,256
Gross profit	28,432	21,872	52,304	42,764
Operating expenses:				
Research and development	4,232	3,418	8,179	6,591
Sales and marketing	11,476	9,902	21,054	19,930
General and administrative	3,797	2,853	6,705	5,908
Total operating expenses	19,505	16,173	35,938	32,429
Income from operations	8,927	5,699	16,366	10,335
Interest and other income (expense), net	(445)	507	(398)	911
Income before income tax provision	8,482	6,206	15,968	11,246
Income tax provision	3,082	2,210	5,853	4,021
Net income	$5,400	$3,996	$10,115	$7,225
Net income per share:				
Basic net income per share	$0.24	$0.18	$0.45	$0.32
Diluted net income per share	$0.24	$0.18	$0.45	$0.32
Shares used in the calculation of net income per share:				
Weighted average common shares outstanding - basic	22,507,000	22,306,000	22,458,000	22,268,000
Weighted average common shares outstanding - diluted	22,690,000	22,574,000	22,678,000	22,589,000
Cash dividends declared per share	$0.10	$-	$0.20	$-

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

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ABAXIS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(In thousands)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Net income	$5,400	$3,996	$10,115	$7,225
Other comprehensive income (loss):				
Net change in unrealized gain (loss) on investments	(28)	8	(20)	(14)
Tax provision (benefit) on other comprehensive income (loss)	(11)	3	(7)	(6)
Other comprehensive income (loss), net of tax	(17)	5	(13)	(8)
Comprehensive income	$5,383	$4,001	$10,102	$7,217

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

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

	Six Months Ended September 30,	
	2014	2013
Cash flows from operating activities:		
Net income	$10,115	$7,225
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,166	3,584
Investment premium amortization, net	301	322
Net loss on disposals of property and equipment	2	6
Foreign exchange (gain) loss	564	(406)
Share-based compensation expense	4,527	4,102
Excess tax benefits from share-based awards	(859)	(1,729)
Deferred income taxes	(1,517)	(428)
Equity in net (income) loss of unconsolidated affiliate	32	(16)
Changes in assets and liabilities:		
Receivables, net	(7,214)	4,962
Inventories	(3,223)	(1,174)
Prepaid expenses and other current assets	(815)	(699)
Other assets	(60)	13
Accounts payable	4,053	(1,126)
Accrued payroll and related expenses	4,148	(769)
Accrued taxes	(214)	(17)
Other accrued liabilities	2,483	(460)
Deferred rent	-	22
Deferred revenue	(441)	535
Warranty reserve	317	229
Net cash provided by operating activities	16,365	14,176
Cash flows from investing activities:		
Purchases of held-to-maturity investments	(13,650)	(8,036)
Proceeds from maturities and redemptions of available-for-sale investments	498	525
Proceeds from maturities and redemptions of held-to-maturity investments	18,729	15,113
Purchases of property and equipment	(3,904)	(2,761)
Proceeds from disposals of property and equipment	-	9
Net cash provided by investing activities	1,673	4,850
Cash flows from financing activities:		
Proceeds from the exercise of stock options	4	26
Tax withholdings related to net share settlements of restricted stock units	(2,884)	(4,591)
Excess tax benefits from share-based awards	859	1,729
Proceeds from the exercise of warrants	60	-
Dividends paid	(4,498)	-
Net cash used in financing activities	(6,459)	(2,836)
Effect of exchange rate changes on cash and cash equivalents	(574)	346
Net increase in cash and cash equivalents	11,005	16,536
Cash and cash equivalents at beginning of period	73,589	54,910
Cash and cash equivalents at end of period	$84,594	$71,446

Supplemental disclosure of cash flow information:		
Cash paid for income taxes, net of refunds	$7,138	$4,006
Supplemental disclosure of non-cash flow information:		
Change in unrealized gain (loss) on investments, net of tax	$(13)	$(8)
Transfers of equipment between inventory and property and equipment, net	$1,223	$618
Net change in capitalized share-based compensation	$9	$26
Common stock withheld for employee taxes in connection with share-based compensation	$2,884	$4,591
Repayment of notes payable by credits from municipal agency	$50	$50

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

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ABAXIS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Abaxis, Inc. ("Abaxis," the "Company" or "we"), incorporated in California in 1989, develops, manufactures, markets and sells portable blood analysis systems that are used in a broad range of medical specialties in human or veterinary patient care to provide clinicians with rapid blood constituent measurements. Abaxis provides veterinary reference laboratory diagnostic and consulting services for veterinarians. We conduct business worldwide and manage our business on the basis of the following two reportable segments: the medical market and the veterinary market.

Abaxis Europe GmbH, our wholly-owned subsidiary in Griesheim, Germany, markets, promotes and distributes diagnostic systems for medical and veterinary uses in the European market.

Basis of Presentation

We have prepared the unaudited condensed consolidated financial statements included herein pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim periods. The unaudited condensed consolidated financial statements included herein reflect all normal recurring adjustments, which are, in the opinion of our management, necessary to state fairly the results of operations and financial position for the periods presented. The results for the three and six month periods ended September 30, 2014 are not necessarily indicative of the results to be expected for the entire fiscal year ending March 31, 2015 or for any interim or future period.

These unaudited condensed consolidated financial statements and related notes should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2014.

Principles of Consolidation. The accompanying unaudited condensed consolidated financial statements include the accounts of Abaxis and our wholly-owned subsidiary, Abaxis Europe GmbH. Intercompany transactions and balances have been eliminated in consolidation.

Reclassifications. Certain reclassifications have been made to prior periods' financial statements to conform to the current period presentation. These reclassifications did not result in any change in previously reported net income or shareholders' equity.

Management Estimates. The preparation of these condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, the reported amounts of revenues and expenses during the reporting period, and related disclosures. Significant management estimates made in preparing the condensed consolidated financial statements relate to allowance for doubtful accounts, sales and other allowances, estimated selling price of our products, valuation of inventory, fair value of investments, fair value and useful lives of intangible assets, income taxes, valuation allowance for deferred tax assets, share-based compensation, legal exposures and warranty reserves. Our management bases their estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Our actual results may differ materially from these estimates.

Significant Accounting Policies

The significant accounting policies used in preparation of these condensed consolidated financial statements are disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2014 filed with the SEC on May 30, 2014, and have not changed significantly since such filing.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

Compensation—Stock Compensation: In June 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-12, “Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period,” (Topic 718) (“ASU 2014-12”). The accounting standard update clarifies the accounting guidance on how to account for share-based payment awards that require a specific performance target to be achieved in order for employees to become eligible to vest in the awards. ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation costs should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has been rendered. ASU 2014-12 is effective for annual periods and interim periods beginning after December 15, 2015 and early adoption is permitted. This amendment may be applied (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. We are currently in the process of evaluating the impact of adopting this pronouncement.

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Revenue from Contracts with Customers: In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers,” (Topic 606) (“ASU 2014-09”), which supersedes the revenue recognition requirements in Accounting Standards Codification 605, “Revenue Recognition.” ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of 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. It also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is effective for fiscal years beginning after December 15, 2016, as well as interim periods within those fiscal years. We are currently in the process of evaluating the impact of adopting this pronouncement.

NOTE 3. INVESTMENTS

Our investments are classified as either available-for-sale or held-to-maturity. The following table summarizes available-for-sale and held-to-maturity investments as of September 30, 2014 and March 31, 2014 (in thousands):

	Available-for-Sale Investments			
September 30, 2014	Amortized Cost	Gross Unrealized Gain	Gross Unrealized (Loss)	Fair Value
Corporate bonds	$10,366	$ 7	$ (36)	$10,337
Total available-for-sale investments	$10,366	$ 7	$ (36)	$10,337

	Held-to-Maturity Investments			
September 30, 2014	Amortized Cost	Gross Unrecognized Gain	Gross Unrecognized (Loss)	Fair Value
Certificates of deposit	$4,477	$ -	$ (6)	$4,471
Commercial paper	3,995	1	(1)	3,995
Corporate bonds	19,855	31	(85)	19,801
Municipal bonds	3,031	17	(3)	3,045
Total held-to-maturity investments	$31,358	$ 49	$ (95)	$31,312

	Available-for-Sale Investments			
March 31, 2014	Amortized Cost	Gross Unrealized Gain	Gross Unrealized (Loss)	Fair Value
Certificates of deposit	$498	$ 1	$ -	$499
Corporate bonds	10,392	32	(42)	10,382
Total available-for-sale investments	$10,890	$ 33	$ (42)	$10,881

	Held-to-Maturity Investments			
March 31, 2014	Amortized Cost	Gross Unrecognized Gain	Gross Unrecognized (Loss)	Fair Value
Certificates of deposit	$5,722	$ -	$ (8)	$5,714
Commercial paper	12,991	-	(1)	12,990
Corporate bonds	14,920	65	(33)	14,952
Municipal bonds	3,079	20	(29)	3,070
Total held-to-maturity investments	$36,712	$ 85	$ (71)	$36,726

The amortized cost of our held-to-maturity investments approximates their fair value. As of September 30, 2014 and March 31, 2014, we did not have other-than-temporary impairment in the fair value of any individual security classified as held-to-maturity or available-for-sale. As of September 30, 2014 and March 31, 2014, we had unrealized losses on available-for-sale investments, net of related income taxes of $18,000 and $5,000, respectively. During the three months ended September 30, 2014 and 2013, we did not have any redemption of investments in accordance with callable provisions. During the six months ended September 30, 2014 and 2013, redemptions of investments in accordance with callable provisions were $1.3 million and $623,000, respectively.

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The following table summarizes the amortized cost and fair value of our investments, classified by stated maturity as of September 30, 2014 and March 31, 2014 (in thousands):

	September 30, 2014 Available-for-Sale Investments		September 30, 2014 Held-to-Maturity Investments	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in less than one year	$6,003	$6,010	$14,834	$14,821
Due in 1 to 4 years	4,363	4,327	16,524	16,491
Total investments	$10,366	$10,337	$31,358	$31,312

	March 31, 2014 Available-for-Sale Investments		March 31, 2014 Held-to-Maturity Investments	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in less than one year	$6,509	$6,542	$22,560	$22,571
Due in 1 to 4 years	4,381	4,339	14,152	14,155
Total investments	$10,890	$10,881	$36,712	$36,726

NOTE 4. FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. There is a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

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

Level 2: Directly or indirectly observable inputs as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in the models, such as interest rates and volatility factors, are corroborated by readily observable data from actively quoted markets for substantially the full term of the financial instrument.

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

The following table summarizes financial assets, measured at fair value on a recurring basis, by level within the fair value hierarchy as of September 30, 2014 and March 31, 2014 (in thousands):

	As of September 30, 2014		
	Quoted Prices	Significant Other Observable	Significant Unobservable Inputs

	in Active Markets for Identical Assets Level 1	Inputs Level 2	Level 3	Total
Assets				
Cash equivalents	$11,053	$ -	$ -	$11,053
Available-for-sale investments:				
Corporate bonds	-	10,337	-	10,337
Total assets at fair value	$11,053	$ 10,337	$ -	$21,390

	As of March 31, 2014			
	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total
Assets				
Cash equivalents	$5,035	$ -	$ -	$5,035
Available-for-sale investments:				
Certificates of deposit	-	499	-	499
Corporate bonds	-	10,382	-	10,382
Total assets at fair value	$5,035	$ 10,881	$ -	$15,916

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As of September 30, 2014 and March 31, 2014, our Level 1 financial assets consisted of money market mutual funds. Our cash equivalents are highly liquid instruments with original or remaining maturities of three months or less at the time of purchase that are readily convertible into cash. The fair value of our Level 1 financial assets is based on quoted market prices of the underlying security.

Our Level 2 financial assets primarily consist of certificates of deposit and corporate bonds. For our Level 2 financial assets, we review trading activity and pricing for these investments as of the measurement date. When sufficient quoted pricing for identical securities is not available, we use market pricing and other observable market inputs for similar securities obtained from third party data providers. These inputs represent quoted prices for similar assets in active markets or these inputs have been derived from observable market data.

As of September 30, 2014 and March 31, 2014, we did not have any Level 1 and Level 2 financial liabilities or Level 3 financial assets or liabilities measured at fair value on a recurring basis. We did not have any transfers between Level 1 and Level 2 or transfers in or out of Level 3 during the three and six months ended September 30, 2014 and 2013.

NOTE 5. INVENTORIES

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

	September 30, 2014	March 31, 2014
Raw materials	$ 13,853	$14,348
Work-in-process	3,149	3,463
Finished goods	11,985	9,167
Inventories	$ 28,987	$26,978

NOTE 6. INVESTMENT IN UNCONSOLIDATED AFFILIATE

Our investment in an unconsolidated affiliate consists of an investment in equity securities of Scandinavian Micro Biodevices APS (“SMB”). In February 2011, we purchased a 15% equity ownership interest in SMB for $2.8 million in cash. SMB is a privately-held developer and manufacturer of point-of-care diagnostic products for veterinary use. SMB, based in Farum, Denmark, has been the original equipment manufacturer of the Abaxis VetScan VSpro point-of-care specialty analyzer since 2008. We accounted for our investment in SMB using the equity method due to our significant influence over SMB’s operations. Our allocated portions of SMB’s net income (loss) during the three months ended September 30, 2014 and 2013 were $17,000 and $(14,000), respectively, and during the six months ended September 30, 2014 and 2013 were $(32,000) and $16,000, respectively.

NOTE 7. WARRANTY RESERVES

We provide for the estimated future costs to be incurred under our standard warranty obligation on our instruments and reagent discs.

Instruments. Our standard warranty obligation on instruments ranges from one to five years, depending on the specific product. The estimated contractual warranty obligation is recorded when the related revenue is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated. Cost of revenues reflects estimated warranty expense for instruments sold in the current period and any adjustments in estimated warranty expense for the installed base under our standard warranty obligation based on our quarterly evaluation of service

experience. The estimated accrual for warranty exposure is based on historical experience as to product failures, estimated product failure rates, estimated repair costs, material usage and freight incurred in repairing the instrument after failure and known design changes under the warranty plan. Management periodically evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. If an unusual performance rate related to warranty claims is noted, an additional warranty accrual may be assessed and recorded when a failure event is probable and the cost can be reasonably estimated. Effective October 2013, management prospectively changed the standard warranty obligations on certain instruments sold from three to five years. The increase in the standard warranty period did not result in a material impact on our cost of revenues or our accrued warranty costs during fiscal 2014 or during the three and six months ended September 30, 2014. Total accrued warranty reserve related to instruments at September 30, 2014 and March 31, 2014 was $1.7 million and $1.2 million, respectively. The change in total accrued warranty reserve from March 31, 2014 to September 30, 2014 was primarily due to an increase in the number of instruments in standard warranty during the six months ended September 30, 2014.

Reagent Discs. We record a provision for defective reagent discs when the related sale is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated. The warranty cost includes the replacement costs and freight of a defective reagent disc. The balance of accrued warranty reserve related to replacement of defective reagent discs at September 30, 2014 and March 31, 2014 was $478,000 and $619,000, respectively, which was classified as a current liability on the condensed consolidated balance sheets.

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We evaluate our estimates for warranty reserves on an ongoing basis and believe we have the ability to reasonably estimate warranty costs. However, unforeseeable changes in factors may impact the estimate for warranty and such changes could cause a material change in our warranty reserve accrual in the period in which the change was identified.

The change in our accrued warranty reserve during the three and six months ended September 30, 2014 and 2013 is summarized as follows (in thousands):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Balance at beginning of period	$1,873	$1,327	$1,868	$1,384
Provision for warranty expense	656	672	1,048	999
Warranty costs incurred	(344)	(386)	(731)	(770)
Balance at end of period	2,185	1,613	2,185	1,613
Non-current portion of warranty reserve	992	741	992	741
Current portion of warranty reserve	$1,193	$872	$1,193	$872

NOTE 8. BORROWINGS

Notes Payable. We have a ten year loan agreement with the Community Redevelopment Agency of the City of Union City (“the Agency”) whereby the Agency provides us with an unsecured loan of up to $1.0 million, primarily to purchase capital equipment. The loan was effective January 2011, bears interest at 5.0% and is payable quarterly. As of September 30, 2014, our short-term and long-term notes payable balances were $100,000 and $531,000, respectively, and we recorded the short-term balance in “Other accrued liabilities” on the condensed consolidated balance sheets. The entire outstanding balance of the note is payable in full on the earlier of: (i) December 2020, or (ii) the date Abaxis ceases operations in Union City, California. The Agency also has the right to accelerate the maturity date and declare all balances immediately due and payable upon the event of default as defined in the loan agreement. We evaluate covenants in our loan agreement on a quarterly basis, and we were in compliance with such covenants as of September 30, 2014.

In accordance with the terms of the loan agreement, the Agency will provide Abaxis with an annual credit that can be applied against the accrued interest and outstanding principal balance on a quarterly basis. The Agency determines the annual credit based on certain taxes paid by Abaxis to the City of Union City, California for a specified period, as defined in the loan agreement. We anticipate that our annual credits from the Agency will be used to fully repay our notes payable due to the Agency. We may carry forward unused quarterly credits to apply against our outstanding balance in a future period. Credits applied to repay our notes payable and accrued interest are recorded in “Interest and other income (expense), net” on the condensed consolidated statements of income.

NOTE 9. COMMITMENTS AND CONTINGENCIES

Commitments

We have purchase commitments, consisting of supply and inventory related agreements, totaling approximately $11.2 million as of September 30, 2014. These purchase order commitments include our purchase obligations to purchase VSpro specialty analyzers and related cartridges from SMB of Denmark through calendar year 2016 and obligations to purchase Diatron hematology instruments from Diatron of Hungary through fiscal year 2015.

Patent Licensing Agreement. Effective January 2009, we entered into a license agreement with Alere. Under our license agreement, we licensed co-exclusively certain worldwide patent rights related to lateral flow immunoassay technology in the field of animal health diagnostics in the professional marketplace. The license agreement provides that Alere shall not grant any future rights to any third parties under its current lateral flow patent rights in the animal health diagnostics field in the professional marketplace. The license agreement enables us to develop and market products under rights from Alere to address animal health and laboratory animal research markets.

In exchange for the license rights, we (i) paid an up-front license fee of $5.0 million to Alere in January 2009, (ii) agreed to pay royalties during the term of the agreement, based solely on sales of products in a jurisdiction country covered by valid and unexpired claims in that jurisdiction under the licensed Alere patent rights, and (iii) agreed to pay a yearly minimum license fee of between $500,000 to $1.0 million per year, which fee will be creditable against any royalties due during such calendar year. The royalties, if any, are payable through the date of the expiration of the last valid patent licensed under the agreement that includes at least one claim in a jurisdiction covering products we sell in that jurisdiction. The yearly minimum fees are payable for so long as we desire to maintain exclusivity under the agreement.

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Litigation

On October 1, 2012, St. Louis Police Retirement System, a purported shareholder of Abaxis, filed a lawsuit against certain officers and each of the directors of the Company in the United States District Court for the Northern District of California alleging, among other things, that the directors violated Section 14(a) of the Securities Exchange Act of 1934 and breached their fiduciary duties by allegedly failing to disclose material information in our 2010 proxy statement, breached their fiduciary duties by allegedly violating the terms of our 2005 Equity Incentive Plan, and breached their fiduciary duties by failing to disclose alleged material information in our 2012 proxy statement regarding (1) the events leading up to our proposal to amend the 2005 Equity Incentive Plan to eliminate the limit on the number of shares that may be issued pursuant to restricted stock units, and (2) the effects of the proposed amendment on certain settled and outstanding restricted stock units. The plaintiff seeks, among other things, damages, disgorgement and attorney's fees. In addition, the plaintiff sought, and on October 23, 2012, the court issued, an order preliminarily enjoining our shareholder vote on Proposal 2 in our 2012 proxy statement, regarding an amendment to the 2005 Equity Incentive Plan, until such time as additional disclosures could be made. We filed with the SEC and mailed to shareholders supplemental proxy materials approved by the court, the injunction was lifted and our shareholders approved the proposal to amend our 2005 Equity Incentive Plan. A hearing on defendants' motion to dismiss the claims was held on May 7, 2013.

On October 1, 2013, before the court ruled on the motions to dismiss, the parties notified the court that they had reached a settlement of the lawsuit. On January 16, 2014, the parties entered into a Stipulation of Settlement, and the following day, the plaintiff filed a motion for preliminary approval. On April 15, 2014, the court issued an order granting preliminary approval of the settlement. A hearing on the motion for final approval of the settlement and the plaintiff's petition for attorney's fees was held on June 17, 2014. On August 12, 2014, the Court issued a final judgment order, among other things, approving the settlement. Pursuant to the settlement, the parties have agreed that the claims against the defendants will be dismissed with prejudice and will be granted the release of certain known or unknown claims that have been or could have been brought later in the court arising out of the same allegations. We have also agreed that we will adopt certain corporate governance measures, such measures to be in effect for at least five years. The court also awarded $579,430 in attorney's fees and costs to plantiff's counsel, which was paid by the Company's insurance. We believe that the attorney's fees that were awarded to the plaintiff's counsel did not have a material adverse effect on Abaxis, our consolidated financial position or our results of operations.

We are involved from time to time in various litigation matters in the normal course of business. There can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows.

NOTE 10. EQUITY COMPENSATION PLANS AND SHARE-BASED COMPENSATION

Equity Compensation Plan

As of September 30, 2014, we had one equity incentive plan under which our equity securities are authorized for issuance to our employees, directors and consultants. Our 2005 Equity Incentive Plan (the "2005 Plan") restated and amended our 1998 Stock Option Plan. The 2005 Plan allowed for the awards of stock options, stock appreciation rights, restricted stock awards, restricted stock units, performance cash awards, performance shares, performance units, deferred compensation awards or other share-based awards to employees, directors and consultants. As of September 30, 2014, the 2005 Plan provided for the issuance of a maximum of 6,786,000 shares, of which 875,505 shares of common stock were then available for future issuance. Shares that are canceled or forfeited from an award and shares withheld in satisfaction of tax withholding obligations are again available for issue under the Equity Incentive Plan. Our 2005 Plan was scheduled to terminate in 2015.

On October 22, 2014, our shareholders approved our 2014 Equity Incentive Plan (the "2014 Plan"). The 2014 Plan is the successor to and continuation of the 2005 Plan and no additional awards have been or will be made after October 22, 2014 under the 2005 Plan. The terms of the 2014 Plan provide for the grant of incentive stock options, nonstatutory stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards, other stock awards and performance awards that may be settled in cash, stock or other property. The total number of shares of the Company's common stock available for issuance under the 2014 Plan is initially 1,712,409 shares, which is equal to the sum of (i) 875,505 shares remaining available for issuance pursuant to the exercise of options or issuance or settlement of stock awards that have not previously been granted under the 2005 Plan, as of the effective date of the 2014 Plan (the "2005 Plan's Available Reserve") and (ii) up to 836,904 Returning Shares (as defined below), as such shares become available from time to time. The "Returning Shares" are shares subject to outstanding stock awards granted under the 2005 Plan and the Abaxis, Inc. 1998 Stock Option Plan that, from and after the effective date of the 2014 Plan, (i) expire or terminate for any reason prior to exercise or settlement, (ii) are forfeited, cancelled or otherwise returned to us because of the failure to meet a contingency or condition required for the vesting of such shares, or (iii) are reacquired or withheld (or not issued) by us to satisfy a tax withholding obligation in connection with a stock award or to satisfy the purchase price or exercise price of a stock award.

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

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Share-Based Compensation

The following table summarizes total share-based compensation expense, net of tax, related to restricted stock units during the three and six months ended September 30, 2014 and 2013, which is included in our condensed consolidated statements of income (in thousands, except per share data):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Cost of revenues	$414	$298	$755	$552
Research and development	378	215	819	582
Sales and marketing	701	595	1,527	1,301
General and administrative	1,002	745	1,426	1,667
Share-based compensation expense before income taxes	2,495	1,853	4,527	4,102
Income tax benefit	(840)	(633)	(1,524)	(1,401)
Total share-based compensation expense after income taxes	$1,655	$1,220	$3,003	$2,701
Net impact of share-based compensation on:				
Basic net income per share	$0.07	$0.05	$0.13	$0.12
Diluted net income per share	$0.07	$0.05	$0.13	$0.12

Share-based compensation has been classified in the condensed consolidated statements of income or capitalized on the condensed consolidated balance sheets in the same manner as cash compensation paid to employees. Capitalized share-based compensation costs at September 30, 2014 and March 31, 2014 were $146,000 and $137,000, respectively, which were included in inventories on our condensed consolidated balance sheets.

Cash Flow Impact

The accounting standard with respect to share-based payment requires cash flows resulting from excess tax benefits to be classified as a part of cash flows from financing activities. Excess tax benefits are realized tax benefits from tax deductions for exercised stock options and vested restricted stock units in excess of the deferred tax asset attributable to share-based compensation expense for such share-based awards. Excess tax benefits are considered realized when the tax deductions reduce taxes that otherwise would be payable. Excess tax benefits classified as a financing cash inflow for the three months ended September 30, 2014 and 2013 were $759,000 and $332,000, respectively, and for the six months ended September 30, 2014 and 2013 were $859,000 and $1.7 million, respectively.

Stock Options

Prior to fiscal 2007, we granted stock option awards to employees and directors as part of our share-based compensation program. Option awards to consultants were insignificant. Options granted to employees and directors generally expire ten years from the grant date. Options granted to employees generally become exercisable over a period of four years based on cliff-vesting terms and continuous employment. Options granted to non-employee directors generally become exercisable over a period of one year based on monthly vesting terms and continuous service. We have not granted any stock options since the beginning of fiscal 2007. We have recognized compensation expense for stock options granted during the requisite service period of the stock option. As of September 30, 2014, we had no unrecognized compensation expense related to stock options granted.

Stock Option Activity

The following table summarizes information regarding options outstanding and options exercisable at September 30, 2014 and the changes during the six-month period then ended:

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (In thousands)
Outstanding at March 31, 2014	2,000	$ 13.24		
Granted	-	-		
Exercised	(200)	19.45		
Canceled or forfeited	-	-		
Outstanding at September 30, 2014	1,800	$ 12.65	0.38	$ 79
Vested and expected to vest at September 30, 2014	1,800	$ 12.65	0.38	$ 79
Exercisable at September 30, 2014	1,800	$ 12.65	0.38	$ 79

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The aggregate intrinsic value in the table above represents the pre-tax intrinsic value, based on our closing stock price as of September 30, 2014, that would have been received by the option holders had all option holders exercised their stock options as of that date. Total intrinsic value of stock options exercised during the three months ended September 30, 2014 and 2013 was $0 and $10,000, respectively, and during the six months ended September 30, 2014 and 2013 was $4,000 and $91,000, respectively. Cash proceeds from stock options exercised during the three months ended September 30, 2014 and 2013 were $0 and $9,000, respectively, and during the six months ended September 30, 2014 and 2013 were $4,000 and $26,000, respectively.

Restricted Stock Units

Since fiscal 2007, we have granted restricted stock unit awards to employees and directors as part of our share-based compensation program. Restricted stock unit awards to consultants were not significant. Awards of restricted stock units are issued at no cost to the recipient and may have time-based vesting criteria, or a combination of time-based and performance-based vesting criteria, as described below. From time to time, restricted stock unit awards granted to employees may be subject to accelerated vesting upon achieving certain performance-based milestones. Additionally, the Compensation Committee of our Board of Directors (the “Compensation Committee”) in its discretion, may provide in the event of a change in control for the acceleration of vesting and/or settlement of the restricted stock unit held by a participant upon such conditions and to such extent as determined by the Compensation Committee. Our Board of Directors has adopted an executive change in control severance plan, which it may terminate or amend at any time, that provides that awards granted to executive officers will accelerate fully on a change of control. The vesting of non-employee director and officer awards granted under the 2014 Plan automatically will also accelerate in full upon a change in control. Beginning in fiscal 2015, the Compensation Committee discontinued the practice of granting such “single trigger” acceleration of vesting benefits to new executive officers pursuant to which an executive officer’s outstanding stock option(s) and other unvested equity-based instruments would accelerate in full upon the occurrence of a change of control. In fiscal 2015, we granted a “double-trigger” acceleration arrangement to an executive officer, which requires both the occurrence of a change of control and the termination by us (or our successor) for any reason other than cause, death or disability within 18 months following such change of control date, with the termination constituting a separation in service and subject to execution of a valid and effective release of claims against us, for the acceleration of vesting of the executive officer’s equity awards in full.

Restricted Stock Unit Awards (Time Vesting)

Restricted stock unit awards with only time-based vesting terms, which we refer to as restricted stock unit awards (time vesting), entitle holders to receive shares of common stock at the end of a specified period of time. For restricted stock unit awards (time vesting), vesting is based on continuous employment or service of the holder. Upon vesting, the equivalent number of common shares are typically issued net of tax withholdings. If the service vesting conditions are not met, unvested restricted stock unit awards (time vesting) will be forfeited. Generally, restricted stock unit awards (time vesting) vest according to one of the following time-based vesting schedules:

- Restricted stock unit awards to employees: Four-year time-based vesting as follows: five percent vesting after the first year; additional ten percent after the second year; additional 15 percent after the third year; and the remaining 70 percent after the fourth year of continuous employment with the Company.

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

The fair value of restricted stock unit awards (time vesting) used in our expense recognition method is measured based on the number of shares granted and the closing market price of our common stock on the date of grant. Such value is recognized as an expense over the corresponding requisite service period. The share-based compensation expense is reduced for an estimate of the restricted stock unit awards that are expected to be forfeited. The forfeiture estimate is

based on historical data and other factors. In subsequent periods, if actual forfeitures differ from those estimates, an adjustment to share-based compensation expense will be recognized at that time. As of September 30, 2014, the total unrecognized compensation expense related to restricted stock unit awards (time vesting) granted amounted to $19.5 million, which is expected to be recognized over a weighted average service period of 2.0 years.

Restricted Stock Unit Awards (Performance Vesting)

We also began granting restricted stock unit awards subject to performance vesting criteria, which we refer to as restricted stock unit awards (performance vesting), to our executive officers starting in fiscal 2013. Restricted stock unit awards (performance vesting) consist of the right to receive shares of common stock, subject to achievement of time-based criteria and certain corporate performance-related goals over a specified period, as established by the Compensation Committee. For restricted stock units subject to performance vesting, we recognize any related share-based compensation expense ratably over the service period based on the most probable outcome of the performance condition. The fair value of our restricted stock unit awards (performance vesting) used in our expense recognition method is measured based on the number of shares granted, the closing market price of our common stock on the date of grant and an estimate of the probability of the achievement of the performance goals. The amount of share-based compensation expense recognized in any one period can vary based on the attainment or expected attainment of the performance goals. If such performance goals are not ultimately met, no compensation expense is recognized and any previously recognized compensation expense is reversed.

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Fiscal 2014 Performance RSUs. In April 2013, the Compensation Committee approved the grant of restricted stock unit awards (performance vesting) for 129,000 shares of common stock to our executive officers that also contained both time-based and performance-based vesting terms (the "FY2014 Performance RSUs"). The aggregate estimated grant date fair value of the FY2014 Performance RSUs was $5.5 million, or $42.43 per share, based on the closing market price of our common stock on the date of grant. The FY2014 Performance RSUs would have vested only if both of the following criteria were satisfied: (1) our consolidated income from operations for the fiscal year ended March 31, 2014, as certified by the Compensation Committee, was in excess of the applicable target amount described below; and (2) the recipient remained in the service of the Company until the applicable vesting date set forth as follows:

- 25% shares issuable upon settlement of FY2014 Performance RSUs upon satisfying 90% of target of consolidated income from operations for the year ended March 31, 2014 and time-based vesting on April 29, 2016;
- 25% shares issuable upon settlement of FY2014 Performance RSUs upon satisfying 90% of target of consolidated income from operations for the year ended March 31, 2014 and time-based vesting on April 29, 2017;
- 25% shares issuable upon settlement of FY2014 Performance RSUs upon satisfying 100% of target of consolidated income from operations for the year ended March 31, 2014 and time-based vesting on April 29, 2016; and
- 25% shares issuable upon settlement of FY2014 Performance RSUs upon satisfying 100% of target of consolidated income from operations for the year ended March 31, 2014 and time-based vesting on April 29, 2017.

At March 31, 2014, we reviewed each of the underlying performance targets related to the outstanding FY2014 Performance RSUs and determined that it was not probable that the FY2014 Performance RSUs would vest and as a result did not record share-based compensation related to these awards during fiscal 2014. On April 23, 2014, the Compensation Committee determined that the Company's consolidated income from operations for fiscal 2014 was below 90% of target and, accordingly, the FY2014 Performance RSUs did not vest and were cancelled.

Fiscal 2015 Performance RSUs. In April 2014, the Compensation Committee approved the grant of restricted stock unit awards (performance vesting) for 172,000 shares of common stock to our executive officers that also contained both time-based and performance-based vesting terms (the "FY2015 Performance RSUs"). The aggregate estimated grant date fair value of the FY2015 Performance RSUs was $7.0 million, or $40.82 per share, based on the closing market price of our common stock on the date of grant. The FY2015 Performance RSUs will vest only if both of the following criteria are satisfied: (1) our consolidated income from operations for the fiscal year ending March 31, 2015, as certified by the Compensation Committee, is in excess of the applicable target amount described below; and (2) the recipient remains in the service of the Company until the applicable vesting date set forth as follows:

- 25% shares issuable upon settlement of FY2015 Performance RSUs upon satisfying 90% of target of consolidated income from operations for the year ending March 31, 2015 and time-based vesting on April 28, 2017;
- 25% shares issuable upon settlement of FY2015 Performance RSUs upon satisfying 90% of target of consolidated income from operations for the year ending March 31, 2015 and time-based vesting on April 28, 2018;
- 25% shares issuable upon settlement of FY2015 Performance RSUs upon satisfying 100% of target of consolidated income from operations for the year ending March 31, 2015 and time-based vesting on April 28, 2017; and
- 25% shares issuable upon settlement of FY2015 Performance RSUs upon satisfying 100% of target of consolidated income from operations for the year ending March 31, 2015 and time-based vesting on April 28, 2018.

During the three and six months ended September 30, 2014, we recorded share-based compensation expense related to the portion of the FY2015 Performance RSUs, as we determined that it was probable that the performance targets would be met. As of September 30, 2014, the total unrecognized compensation expense related to restricted stock unit awards (performance vesting) granted amounted to $5.0 million, which is expected to be recognized over a weighted average service period of 3.1 years.

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Restricted Stock Unit Activity

The following table summarizes restricted stock unit activity for the six months ended September 30, 2014:

	Time-Based Restricted Stock Units		Performance-Based Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value(1)	Number of Shares	Weighted Average Grant Date Fair Value(1)
Nonvested at March 31, 2014	774,000	$ 30.98	113,000	$ 42.43
Granted	179,000	43.44	172,000	40.82
Vested(2)	(262,000)	27.11	-	-
Canceled and forfeited	(4,000)	31.02	(137,000)	42.15
Nonvested at September 30, 2014	687,000	$ 35.69	148,000	$ 40.82

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

(2) The number of restricted stock units vested includes shares that we withheld on behalf of our employees to satisfy the statutory tax withholding requirements.

Total intrinsic value of restricted stock units vested during the three months ended September 30, 2014 and 2013 was $3.4 million and $2.4 million, respectively, and during the six months ended September 30, 2014 and 2013 was $11.1 million and $12.9 million, respectively. The total grant date fair value of restricted stock units vested during the three months ended September 30, 2014 and 2013 was $1.7 million and $1.5 million, respectively, and during the six months ended September 30, 2014 and 2013 was $7.1 million and $6.9 million, respectively.

NOTE 11. SHAREHOLDERS' EQUITY

Share Repurchase Program

Between August 2011 and January 2012, the Board of Directors authorized the repurchase of up to a total of $55.0 million of our common stock. In July 2013, the Board of Directors approved a $12.3 million increase to our existing share repurchase program to a total of $67.3 million. As of September 30, 2014, $37.0 million was available to purchase common stock under our share repurchase program. Since the share repurchase program began, through September 30, 2014, we have repurchased 1.3 million shares of our common stock at a total cost of $30.3 million, including commission expense. During the three and six months ended September 30, 2014 and 2013, we did not repurchase any shares of our common stock. The repurchases are made from time to time on the open market at prevailing market prices or in negotiated transactions off the market. Repurchased shares are retired.

Dividend Payments

On April 23, 2014, our Board of Directors declared a cash dividend of $0.10 per share on our outstanding common stock, payable on June 17, 2014 to all shareholders of record as of the close of business on June 3, 2014. The total dividend payout was $2.2 million and was made from retained earnings.

On July 23, 2014, our Board of Directors declared a cash dividend of $0.10 per share on our outstanding common stock, payable on September 17, 2014 to all shareholders of record as of the close of business on September 3, 2014. The total dividend payout was $2.3 million and was made from retained earnings.

On October 22, 2014, our Board of Directors declared a cash dividend of $0.10 per share on our outstanding common stock to be paid on December 16, 2014 to all shareholders of record as of the close of business on November 17, 2014. We anticipate paying an additional quarterly dividend during our fourth quarter of fiscal 2015. However, such future declarations of quarterly dividends and the establishment of future record and payment dates are subject to the final determination of our Board of Directors.

Common Stock Warrants

At September 30, 2014, there were warrants to purchase 10,000 shares of common stock outstanding at a weighted average exercise price of $3.00 per share, expiring in fiscal years 2016 through 2017. During the three months ended September 30, 2014, no warrants were exercised. During the six months ended September 30, 2014, we issued 20,000 shares of common stock upon the exercise of vested warrants at an exercise price of $3.00 per share. At September 30, 2014, there were no vested warrants outstanding. At March 31, 2014, there were warrants to purchase 30,000 shares of common stock outstanding, of which 20,000 shares were vested, at a weighted average exercise price of $3.00 per share, expiring in fiscal years 2016 through 2017. The fair value of the warrants issued were determined using the Black-Scholes option-pricing model and are amortized over their estimated useful life, of approximately ten years, as an intangible asset. The warrants vest at a rate of 20% annually from their issuance dates and have a term of five years.

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NOTE 12. NET INCOME PER SHARE

Basic net income per share is computed by dividing the net income attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income attributable to common shareholders by the weighted average number of common shares that would have been outstanding during the period assuming the issuance of common shares for all potential dilutive common shares outstanding using the treasury stock method. Dilutive potential common shares outstanding include outstanding stock options, restricted stock units and warrants.

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Numerator:				
Net income	$5,400	$3,996	$10,115	$7,225
Denominator:				
Weighted average common shares outstanding - basic	22,507,000	22,306,000	22,458,000	22,268,000
Weighted average effect of dilutive securities:				
Stock options	2,000	24,000	2,000	25,000
Restricted stock units	172,000	216,000	201,000	268,000
Warrants	9,000	28,000	17,000	28,000
Weighted average common shares outstanding - diluted	22,690,000	22,574,000	22,678,000	22,589,000
Net income per share:				
Basic net income per share	$0.24	$0.18	$0.45	$0.32
Diluted net income per share	$0.24	$0.18	$0.45	$0.32

Stock options and warrants are excluded from the computation of diluted weighted average shares outstanding if the exercise price of the stock options and warrants is greater than the average market price of our common stock during the period because the inclusion of these stock options and warrants would be antidilutive to net income per share. There were no stock options and warrants excluded from the computation of diluted weighted average shares outstanding during the three and six months ended September 30, 2014 and 2013.

Restricted stock units for 222,000 and 129,000 shares during the three months ended September 30, 2014 and 2013, respectively, and 25,000 and 0 shares during the six months ended September 30, 2014 and 2013, respectively, were outstanding but not included in the computation of diluted net income per share because the effect would be antidilutive. For our restricted stock unit awards (performance vesting), if the performance criteria are achieved during the period, these awards will be considered outstanding for the purpose of computing diluted net income per share if the effect is dilutive. Because the performance criteria for these restricted stock unit awards (performance vesting) were not achieved during the three and six months ended September 30, 2014 and 2013, these awards were not included in the diluted net income per share calculation.

NOTE 13. INCOME TAXES

During the three months ended September 30, 2014 and 2013, our income tax provision was $3.1 million, based on an effective tax rate of 36%, and $2.2 million, based on an effective tax rate of 36%, respectively. The effective tax rate during the three months ended September 30, 2014, as compared to the three months ended September 30, 2013, was impacted by an elimination of federal research and development tax credits resulting from the expiration of the credit for expenses incurred after December 31, 2013, partially offset by an increase in federal tax benefits for qualified

production activities.

During the six months ended September 30, 2014 and 2013, our income tax provision was $5.9 million, based on an effective tax rate of 37%, and $4.0 million, based on an effective tax rate of 36%, respectively. The increase in our effective tax rate during the six months ended September 30, 2014, as compared to the six months ended September 30, 2013, was primarily due to an elimination of federal research and development tax credits resulting from the expiration of the credit for expenses incurred after December 31, 2013.

We did not have any unrecognized tax benefits as of September 30, 2014 and March 31, 2014. During the three and six months ended September 30, 2014 and 2013, we did not recognize any interest or penalties related to unrecognized tax benefits.

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NOTE 14. SEGMENT REPORTING INFORMATION

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

Abaxis develops, manufactures, markets and sells portable blood analysis systems for use in human or veterinary patient care setting to provide clinicians with rapid blood constituent measurements. We identify our reportable segments as those customer groups that represent more than 10% of our combined revenue or gross profit or loss of all reported operating segments. We manage our business on the basis of the following two reportable segments: (i) the medical market and (ii) the veterinary market, which are based on the products sold and services provided by market and customer group. For the products that we manufacture and sell, each reportable segment has similar manufacturing processes, technology and shared infrastructures. The accounting policies for segment reporting are the same as for the Company as a whole. We do not segregate assets by segments since our chief operating decision maker, or decision making group, does not use assets as a basis to evaluate a segment's performance.

Medical Market

In the medical market reportable segment, we serve a worldwide customer group consisting of physicians' office practices across multiple specialties, urgent care, outpatient and walk-in clinics (free-standing or hospital-connected), health screening operations, home care providers (national, regional or local), nursing homes, ambulance companies, oncology treatment clinics, dialysis centers, pharmacies, hospital laboratories, military installations (ships, field hospitals and mobile care units), pharmaceutical clinical trials and cruise ship lines. The products manufactured and sold in this segment primarily consist of Piccolo chemistry analyzers and medical reagent discs.

Veterinary Market

In the veterinary market reportable segment, we serve a worldwide customer group consisting of companion animal hospitals, animal clinics with mixed practices of small animals, birds and reptiles, equine and bovine practitioners, veterinary emergency clinics, veterinary referral hospitals, universities, government, pharmaceutical companies, biotechnology companies and private research laboratories. Our veterinary market product offerings include VetScan chemistry analyzers and veterinary reagent discs, VetScan hematology instruments and related reagent kits, VetScan VSpro specialty analyzers and related consumables, VetScan i STAT analyzers and related consumables and VetScan rapid tests. Since October 2011, our veterinary market services consist of veterinary reference laboratory diagnostic and consulting services for veterinarians in the United States through Abaxis Veterinary Reference Laboratories ("AVRL").

Total Revenues, Cost of Revenues and Gross Profit by Segment

The table below summarizes revenues, cost of revenues and gross profit from our two operating segments and from certain unallocated items for the three and six months ended September 30, 2014 and 2013 (in thousands):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Revenues:				
Medical Market	$7,616	$7,177	$14,861	$13,215
Veterinary Market	45,568	37,915	84,935	74,286
Other(1)	759	759	1,624	1,519

Total revenues	53,943	45,851	101,420	89,020
Cost of revenues:				
Medical Market	4,053	3,999	7,897	7,293
Veterinary Market	21,427	19,961	41,151	38,909
Other(1)	31	19	68	54
Total cost of revenues	25,511	23,979	49,116	46,256
Gross profit:				
Medical Market	3,563	3,178	6,964	5,922
Veterinary Market	24,141	17,954	43,784	35,377
Other(1)	728	740	1,556	1,465
Gross profit	$28,432	$21,872	$52,304	$42,764

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

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NOTE 15. REVENUES BY PRODUCT AND SERVICE CATEGORY AND GEOGRAPHIC REGION AND SIGNIFICANT CONCENTRATIONS

Revenue Information

The following is a summary of our revenues by product and service category (in thousands):

	Three Months Ended September 30,		Six Months Ended September 30,	
Revenues by Product and Service Category	2014	2013	2014	2013
Instruments(1)	$10,105	$13,537	$17,699	$22,212
Consumables(2)	38,138	28,699	72,424	59,298
Other products and services(3)	5,663	3,577	11,223	7,435
Product and service revenues, net	53,906	45,813	101,346	88,945
Development and licensing revenue	37	38	74	75
Total revenues	$53,943	$45,851	$101,420	$89,020

(1) Instruments include chemistry analyzers, hematology instruments, VSpro specialty analyzers and i-STAT analyzers.

(2) Consumables include reagent discs, hematology reagent kits, VSpro specialty cartridges, i-STAT cartridges and rapid tests.

(3) Other products and services include veterinary reference laboratory diagnostic and consulting services.

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

	Three Months Ended September 30,		Six Months Ended September 30,	
Revenues by Geographic Region	2014	2013	2014	2013
North America	$44,511	$37,320	$82,851	$71,972
Europe	7,244	6,446	14,528	12,998
Asia Pacific and rest of the world	2,188	2,085	4,041	4,050
Total revenues	$53,943	$45,851	$101,420	$89,020

Significant Concentrations

During the three months ended September 30, 2014 and 2013, one distributor in the United States, MWI Veterinary Supply, accounted for 19% and 22%, respectively, of our total worldwide revenues. During the six months ended September 30, 2014 and 2013, one distributor in the United States, MWI Veterinary Supply, accounted for 17% and 22%, respectively, of our total worldwide revenues.

Concentration of credit risk with respect to accounts receivable is primarily limited to certain distributors to whom we make significant sales. One distributor in the United States accounted for 22% and 25% of our total receivable balance at September 30, 2014 and March 31, 2014, respectively.

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

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations includes a number of forward-looking statements, which reflect our current views with respect to future events and financial performance. In this report, the words "will," "anticipates," "believes," "expects," "intends," "plans," "future," "projects," "estimates," "wou "could," "should," "might," and similar expressions identify forward-looking statements. These forward-looking statements are subject to certain risks and uncertainties, including but not limited to those discussed below, in Part II, Item 1A of this report and in Part I, Item 1A of our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission (the "SEC"), that could cause actual results to differ materially from historical results or those anticipated. Such risks and uncertainties relate to our manufacturing operations, including the vulnerability of our manufacturing operations to potential interruptions and delays and our ability to manufacture products free of defects, fluctuations in our quarterly results of operations and difficulty in predicting future results, the transition of our U.S. medical sales to Abbott Point of Care, Inc., the performance of our independent distributors, our ability to manage the inventory levels of our distributors effectively, our dependence on certain sole or limited source suppliers, market acceptance of our products and services, expansion of our sales, marketing and distribution efforts, dependence on key personnel, the ability of Abaxis Veterinary Reference Laboratories to compete effectively, the protection of our intellectual property and claims of infringement of intellectual property asserted by third parties, and other risks detailed under "Risk Factors" in this Quarterly Report on Form 10-Q. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We assume no obligation to update any forward-looking statements as circumstances change.

BUSINESS OVERVIEW

Abaxis, Inc. is a worldwide developer, manufacturer and marketer of portable blood analysis systems that are used in a broad range of medical specialties in human or veterinary patient care to provide clinicians with rapid blood constituent measurements. Since October 2011, Abaxis also has been providing veterinary reference laboratory diagnostic and consulting services for veterinarians through Abaxis Veterinary Reference Laboratories ("AVRL").

Our corporate headquarters are located in Union City, California, from which we conduct our manufacturing, warehousing, research and development, regulatory, sales and marketing and administrative activities. We market and sell our products worldwide primarily through independent distributors, supplemented by our direct sales force. Our sales force is primarily located in the United States. Abaxis Europe GmbH, our wholly-owned subsidiary, markets, promotes and distributes diagnostic systems for medical and veterinary uses in the European market. Starting in the third quarter of fiscal 2015, Abaxis Europe GmbH will also market and distribute our products in the Asia Pacific market.

We manage our business in two operating segments, the medical market and veterinary market, as described below. See "Segment Results" in this section for a detailed discussion of financial results.

Medical Market. We serve a worldwide customer group in the medical market consisting of physicians' office practices across multiple specialties, urgent care, outpatient and walk-in clinics (free-standing or hospital-connected), health screening operations, home care providers (national, regional or local), nursing homes, ambulance companies, oncology treatment clinics, dialysis centers, pharmacies, hospital laboratories, military installations (ships, field hospitals and mobile care units), pharmaceutical clinical trials and cruise ship lines. The products manufactured and sold in this segment primarily consist of Piccolo chemistry analyzers and medical reagent discs.

For our products in the human medical market, we employ primarily independent distributors to market our products. Starting in January 2013, we transitioned the majority of our medical product sales to Abbott as our exclusive

distributor in the medical market. Pursuant to our Abbott Agreement, Abbott obtained the exclusive right to sell and distribute our Piccolo Xpress chemistry analyzers and associated consumables in the professionally-attended human healthcare market in the United States and China (including Hong Kong). Effective September 2013, we amended the Abbott Agreement to limit Abbott's territory under such agreement to the United States. Under the Abbott Agreement, we have certain responsibilities for providing technical support and warranty services to Abbott in support of its marketing and sales efforts. The initial term of the Abbott Agreement ends on December 31, 2017, and after the initial term, the Abbott Agreement renews automatically for successive one-year periods unless terminated by either party based upon a notice of non-renewal six months prior to the then-current expiration date.

We will continue to sell and distribute these medical products outside of these market segments as to which Abbott has exclusive rights. Under our Abbott Agreement, we will continue to sell and distribute to Catapult Health LLC and specified customer segments in the United States, including pharmacy and retail store clinics, shopping malls, clinical research organizations and cruise ship lines.

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Veterinary Market. Our VetScan products serve a worldwide customer group in the veterinary market consisting of companion animal hospitals, animal clinics with mixed practices of small animals, birds and reptiles, equine and bovine practitioners, veterinary emergency clinics, veterinary referral hospitals, universities, government, pharmaceutical companies, biotechnology companies and private research laboratories. Our veterinary market product offerings include VetScan chemistry analyzers and veterinary reagent discs, VetScan hematology instruments and related reagent kits, VetScan VSpro specialty analyzers and related consumables, VetScan i-STAT analyzers and related consumables and VetScan rapid tests. Since October 2011, our veterinary market services consist of veterinary reference laboratory diagnostic and consulting services for veterinarians in the United States through AVRL.

We depend on a number of distributors in North America that distribute our VetScan products. In September 2012, we entered into a distribution agreement with MWI Veterinary Supply, Inc. (“MWI”) to purchase, market and sell the full line of Abaxis veterinary products throughout the United States. In the United States veterinary market segment, we also rely on various independent regional distributors. We continue to enter into additional distributor relationships to expand our distribution base in North America. In October 2014, we entered into distribution agreements with Henry Schein Animal Health and Patterson Veterinary Supply to sell the full line of Abaxis veterinary products throughout the United States. We depend on our distributors to assist us in promoting our VetScan products, and accordingly, if one or more of our distributors were to stop selling our products in the future, we may experience a temporary sharp decline or delay in our sales revenues until our customers identify another distributor or purchase products directly from us. In addition to selling through distributors, we also directly supply our VetScan products to large group purchasing organizations, hospital networks and other buying groups in the United States, such as Veterinary Centers of America (VCA), a veterinary hospital chain in North America. In May 2014, we entered into two long-term agreements with VCA, Inc., relating to (i) a long-term product supply agreement for VCA's Animal Hospitals and (ii) a co-marketing agreement with VCA's Antech Diagnostic reference laboratories.

Overview of Financial Results

In the second quarter of fiscal 2015, total revenues were $53.9 million, an increase of 18% over last year’s comparable quarter. The net increase in revenues was primarily due to an increase in VetScan chemistry analyzers and related reagent disc sales and an increase in service revenues from veterinary reference laboratory diagnostic and consulting services. Gross profit in the second quarter of fiscal 2015 was $28.4 million, an increase of 30% over last year’s comparable quarter, primarily attributable to higher unit sales of reagent discs in our veterinary market.

Total operating expenses in the second quarter of fiscal 2015 were $19.5 million, an increase of $3.3 million, compared to the same period last year, primarily attributable to an increase in employee bonus compensation expense due to meeting company performance targets for the quarter.

Net income in the second quarter of fiscal 2015 was $5.4 million, an increase of $1.4 million, compared to the same period last year, due primarily to the increased revenues described above, partially offset by the expenses discussed above and an increase in our income tax provision of $872,000. Our diluted earnings per share increased to $0.24 in the second quarter of fiscal 2015 from $0.18 for the same period last year.

Cash, cash equivalents and investments increased by $5.1 million during the six months ended September 30, 2014 to a total of $126.3 million at September 30, 2014. The primary source of cash and cash equivalents during the six months ended September 30, 2014 was operating cash flows of $16.4 million. Key non-operating uses of cash during the six months ended September 30, 2014 included capital expenditures of $3.9 million, payments made for tax withholdings related to net share settlements of restricted stock units of $2.9 million and payment of $4.5 million in cash dividends to shareholders.

Factors that May Impact Future Performance

Our industry is impacted by numerous competitive, regulatory and other significant factors. Our sales for any future periods are not predictable with a significant degree of certainty, and may depend on a number of factors outside of our control, including but not limited to inventory or timing considerations by our distributors. During fiscal 2014, our medical market business in the United States was impacted by our continuing transition to a new distribution partner, as described below. Additionally, during fiscal 2014 and the first half of fiscal 2015, our veterinary market business in the United States was impacted by our continuing transition to a new distribution partner, as described below.

During the fourth quarter of fiscal 2013, we transitioned the majority of our medical sales to Abbott as our exclusive distributor in the medical market in the United States. As such, we rely on Abbott and we no longer have control over the marketing and sale of our primary medical products into most of the U.S. medical market and we are dependent upon the efforts and priorities of Abbott in promoting and creating a demand for such products in such market. During fiscal 2014, we were impacted by the timing of purchases of our medical products sold to Abbott as it continued to integrate our products into its sales process and work through its inventory.

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In the United States veterinary market, we rely on MWI, a national distributor, and on various independent regional distributors. During fiscal 2014, our strategy of increasing demand for our veterinary products through the expansion of our distribution partners, did not lead to the increased demand for our products in the veterinary clinics that we had anticipated. During the second half of fiscal 2014, as compared to the same period in fiscal 2013, our sales orders from our largest distributors in the veterinary market decreased resulting from excess channel inventory created during the second half of fiscal 2013 and first half of fiscal 2014. Such excess inventory was the result of our distributors not selling our products to end customers at the same rate as they were purchasing products from us. Although demand for instrument sales from our distributors' end customers continued to grow during the third and fourth quarters of fiscal 2014, it was less than the demand forecasted earlier in the year by our largest distributors and the distributors' ordering rates. Beginning in the second half of fiscal 2014, we have been taking additional steps to more closely monitor and manage channel inventory in an effort to normalize the veterinary product inventories at our distribution partners in the United States. As a result of these efforts, we believe that our distributors' purchases of our chemistry analyzers and related reagent discs were more in line with in-clinic sales starting in the first quarter of our fiscal 2015. For the hematology, i-STAT and VSpro specialty veterinary products that we sell in the United States, sales orders from our largest distributors in the veterinary market decreased during the first half of fiscal 2015, as compared to the same period in fiscal 2014, resulting from excess channel inventory created during the first half of fiscal 2014. We will continue to closely monitor and manage channel inventory at our veterinary distribution partners in the United States.

We are dependent upon the efforts and priorities of our distributors in promoting and creating a demand for our products and as such, we do not have control over the marketing and sale of our products into these markets. Should these efforts be unsuccessful, or should we fail to maintain these relationships, our business, financial condition and results of operations are likely to be adversely affected. We generally operate with a limited order backlog because our products are typically shipped shortly after orders are received. Product sales in any quarter are generally dependent on orders booked and shipped in that quarter. As a result, any such revenues shortfall would negatively affect our operating results and financial condition. In addition, our sales may be adversely impacted by pricing pressure from competitors. Our ability to be consistently profitable will depend, in part, on our ability to increase the sales volumes of our products, to achieve profitability in AVRL, the sales performances of our products by our independent distributors, and to successfully compete with other competitors. We believe that period to period comparisons of our results of operations are not necessarily meaningful indicators of future results.

CRITICAL ACCOUNTING POLICIES, ESTIMATES AND JUDGMENTS

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

We have identified the policies below as critical because they are not only important to understanding our financial condition and results of operations, but also because application and interpretation of these policies requires both judgment and estimates of matters that are inherently uncertain and unknown. Accordingly, actual results may differ materially from our estimates. The impact and any associated risks related to these policies on our business operations are discussed below. A more detailed discussion on the application of these and other accounting policies are included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2014.

Revenue Recognition. Our primary customers are distributors and direct customers in both the medical and veterinary markets. Service revenues are primarily generated from veterinary reference laboratory diagnostic and consulting services for veterinarians. Revenues from product sales and services, net of estimated sales allowances, discounts and rebates, are recognized when (i) evidence of an arrangement exists, (ii) upon shipment of the products or rendering of services to the customer, (iii) the sales price is fixed or determinable and (iv) collection of the resulting receivable is reasonably assured. Rights of return are not provided. From time to time, we offer discounts on AVRL services for a specified period as incentives. Discounts are reductions to invoiced amounts within a specified period and are recorded at the time services are performed. Net service revenues are recognized at the time services are performed.

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

Multiple-element Revenue Arrangements. Our sales arrangements may contain multiple-element revenue arrangements in which a customer may purchase a combination of instruments, consumables or extended maintenance agreements. Additionally, we provide incentives in the form of free goods or extended maintenance agreements to customers in connection with the sale of our instruments. We participate in selling arrangements in the veterinary market that include multiple deliverables, such as instruments, consumables and service agreements associated with our veterinary reference laboratory. Judgments as to the allocation of consideration from an arrangement to the multiple-elements of the arrangement, and the appropriate timing of revenue recognition are critical with respect to these arrangements.

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A multiple-element arrangement includes the sale of one or more tangible product offerings with one or more associated services offerings, each of which are individually considered separate units of accounting. We allocate revenues to each element in a multiple-element arrangement based upon the relative selling price of each deliverable. When applying the relative selling price method, we determine the selling price for each deliverable using vendor-specific objective evidence ("VSOE") of selling price, if it exists, or third-party evidence ("TPE") of selling price. If neither VSOE nor TPE of selling price exist for a deliverable, we use our best estimate of selling price for that deliverable. Revenue allocated to each element is then recognized when all revenue recognition criteria are met for each element.

Revenues from our multiple-element arrangements are allocated separately to the instruments, consumables, extended maintenance agreements and incentives based on the relative selling price method. Amounts allocated to each element are based on its objectively determined fair value, such as the sales price for the product or service when it is sold separately. Revenues allocated to each element are then recognized when the basic revenue recognition criteria, as described above, are met for each element. Revenues associated with incentives in the form of free goods are deferred until the goods are shipped to the customer. Revenues associated with incentives in the form of extended maintenance agreements are deferred and recognized ratably over the life of the extended maintenance contract, generally one to three years. Incentives in the form of extended maintenance agreements are our most significant multiple-element arrangement.

For our selling arrangements in the veterinary market that include multiple deliverables, such as instruments, consumables and service agreements associated with our veterinary reference laboratory, revenue is recognized upon delivery of the product or performance of the service during the term of the service contract when the basic revenue recognition criteria, as described above, are met for each element. We allocate revenues to each element based on the relative selling price of each deliverable. Amounts allocated to each element are based on its objectively determined fair value, such as the sales price for the product or service when it is sold separately.

From time to time, we offer customer incentives consisting of arrangements with customers to include discounts on future sales of services associated with our veterinary reference laboratory. We apply judgment in determining whether future discounts are significant and incremental. When the future discount offered is not considered significant and incremental, we do not account for the discount as an element of the original arrangement. To determine whether a discount is significant and incremental, we look to the discount provided in comparison to standalone sales of the same product to similar customers, the level of discount provided on other elements in the arrangement, and the significance of the discount to the overall arrangement. If the discount in the multiple-element arrangement approximates the discount typically provided in standalone sales, that discount is not considered incremental. During the three and six months ended September 30, 2014 and 2013, our customer incentive programs with future discounts were not significant.

Customer Programs. From time to time, we offer customer marketing and incentive programs. Our most significant customer programs are described as follows:

Instrument Trade-In Programs. We periodically offer trade-in programs to customers for trading in an existing instrument to purchase a new instrument and we will either provide incentives in the form of free goods or reduce the sales price of the instrument. These incentives in the form of free goods are recorded based on the relative selling price method according to the policies described above.

Instrument Rental Programs. We periodically offer programs to customers whereby certain instruments are made available to customers for rent or on an evaluation basis. These programs typically require customers to purchase a minimum quantity of consumables during a specified period for which we recognize revenue on the related consumables according to the policies described above. Depending on the program offered, customers may purchase the instrument during the rental or evaluation period. Proceeds from such sale are recorded as revenue according to

the policies described above. Rental income, if any, are also recorded as revenue according to the policies described above.

Sales Incentive Programs. We periodically offer customer sales incentive programs and we record reductions to revenue related to these programs. Incentives may be provided in the form of volume-based incentives, end-user rebates and discounts. A summary of our revenue reductions is described below. Other rebate programs offered to distributors or customers vary from period to period in the medical and veterinary markets and were not significant.

- Volume-based Incentives. Volume-based incentives, in the form of rebates, are offered from time to time to distributors and group purchasing organizations upon meeting the sales volume requirements during a qualifying period and are recorded as a reduction to gross revenues during a qualifying period. The pricing rebate program is primarily offered to distributors and group purchasing organizations in the North America veterinary market, upon meeting the sales volume requirements of veterinary products during the qualifying period. Factors used in the rebate calculations include the identification of products sold subject to a rebate during the qualifying period and which rebate percentage applies. Based on these factors and using historical trends, adjusted for current changes, we estimate the amount of the rebate that will be paid and record the liability as a reduction to gross revenues when we record the sale of the product. Settlement of the rebate accruals from the date of sale ranges from one to nine months after sale. Changes in the rebate accrual at the end of each period are based upon distributors and group purchasing organizations meeting the purchase requirements during the quarter.

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- End-User Rebates and Discounts. From time to time, cash rebates are offered to end-users who purchase certain products or instruments during a promotional period and are recorded as a reduction to gross revenues. Additionally, we periodically offer sales incentives to end-users, in the form of sales discounts, to purchase consumables for a specified promotional period, typically over five years from the sale of our instrument, and we reimburse resellers for the value of the sales discount provided to the end-user. We estimate the amount of the incentive earned by end-users during a quarter and record a liability to the reseller as a reduction to gross revenues. Factors used in the liability calculation of incentives earned by end-users include the identification of qualified end-users under the sales program during the period and using historical trends. Settlement of the liability to the reseller ranges from one to twelve months from the date an end-user earns the incentive.

Royalty Revenues. Royalties are typically based on licensees' net sales of products that utilize our technology and are recognized as earned in accordance with the contract terms when royalties from licensees can be reliably measured and collectibility is reasonably assured, such as upon the receipt of a royalty statement from the licensee. Our royalty revenue depends on the licensees' use of our technology, and therefore, may vary from period to period and impact our revenues during a quarter.

Allowance for Doubtful Accounts. We recognize revenue when collection from the customer is reasonably assured. We maintain an allowance for doubtful accounts based on our assessment of the collectibility of the amounts owed to us by our customers. We regularly review the allowance and consider the following factors in determining the level of allowance required: the customer's payment history, the age of the receivable balance, the credit quality of our customers, the general financial condition of our customer base and other factors that may affect the customers' ability to pay. An additional allowance is recorded based on certain percentages of our aged receivables, using historical experience to estimate the potential uncollectible. Account balances are charged off against the allowance when we believe it is probable the receivable will not be recovered. If our actual collections experience changes, revisions to our allowances may be required, which could adversely affect our operating income.

Fair Value Measurements. We apply fair value accounting for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining fair value, we consider the principal or most advantageous market in which we would transact and consider assumptions that market participants would use when pricing the asset or liability. The fair value hierarchy distinguishes between (a) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (b) an entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described below.

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities. As of September 30, 2014, our investments in cash equivalents, which we classified as available-for-sale, totaled $11.1 million, using Level 1 inputs since these investments are traded in an active market. The valuations are based on quoted prices of the underlying security that are readily and regularly available in an active market, and accordingly, a significant degree of judgment is not required.

Level 2: Directly or indirectly observable inputs as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in the models, such as interest rates and volatility factors, are corroborated by readily observable data from actively quoted markets for substantially the full term of the financial instrument. As of September 30, 2014, our available-for-sale investments in corporate bonds, totaled $10.3

million, using Level 2 inputs, based on market pricing and other observable market inputs for similar securities obtained from various third party data providers.

Level 3: Unobservable inputs that are supported by little or no market data and require the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions. As of September 30, 2014, we did not have any Level 3 financial assets or liabilities measured at fair value on a recurring basis.

Fair value is a market-based measure considered from the perspective of a market participant who holds the asset or owes the liability rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, our own assumptions are developed to reflect those that market participants would use in pricing the asset or liability at the measurement date. At September 30, 2014, we also had $31.4 million in investments classified as held-to-maturity and carried at amortized cost.

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Investment in Unconsolidated Affiliate. In February 2011, we purchased a 15% equity ownership interest in SMB for $2.8 million in cash. We use the equity method to account for our investment in this entity because we do not control it, but have the ability to exercise significant influence over it. Equity method investments are recorded at original cost and adjusted periodically to recognize (1) our proportionate share of the investees' net income or losses after the date of investment, (2) additional contributions made and dividends or distributions received, and (3) impairment losses resulting from adjustments to net realizable value. We eliminate all intercompany transactions in accounting for our equity method investments. We record our proportionate share of the investees' net income or losses in "Interest and other income (expense), net" on our condensed consolidated statements of income. At September 30, 2014, our investment in unconsolidated affiliate totaled $2.6 million.

We assess the potential impairment of our equity method investments when indicators such as a history of operating losses, a negative earnings and cash flow outlook, and the financial condition and prospects for the investee's business segment might indicate a loss in value. To date, since our investment in SMB, we have not recorded an impairment charge on this investment.

Warranty Reserves. We provide for the estimated future costs to be incurred under our standard warranty obligation on our instruments. Our standard warranty obligation on instruments ranges from one to five years, depending on the specific product. The estimated contractual warranty obligation is recorded when the related revenue is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated. Cost of revenues reflects estimated warranty expense for instruments sold in the current period and any adjustments in estimated warranty expense for the installed base under our standard warranty obligation based on our quarterly evaluation of service experience. While we engage in product quality programs and processes, including monitoring and evaluating the quality of our suppliers, our estimated accrual for warranty exposure is based on our historical experience as to product failures, estimated product failure rates, estimated repair costs, material usage and freight incurred in repairing the instrument after failure and known design changes under the warranty plan. Effective October 2013, we prospectively changed our standard warranty obligations on certain instruments sold from three to five years. The increase in the standard warranty period did not result in a material impact on our cost of revenues or our accrued warranty costs during fiscal 2014 or during the three and six months ended September 30, 2014.

We also provide for the estimated future costs to be incurred under our standard warranty obligation on our reagent discs. A provision for defective reagent discs is recorded and classified as a current liability when the related sale is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated, at which time they are included in cost of revenues. The warranty cost includes the replacement costs and freight of a defective reagent disc.

As of September 30, 2014, our current portion of warranty reserves for instruments and reagent discs totaled $1.2 million and our non current portion of warranty reserves for instruments totaled $992,000, which reflects our estimate of warranty obligations based on the estimated product failure rates, the number of instruments in standard warranty, estimated repair and related costs of instruments, and an estimate of defective reagent discs and replacement and related costs of a defective reagent disc. As of March 31, 2014, our current portion of warranty reserves for instruments and reagent discs totaled $1.0 million and our non-current portion of warranty reserves for instruments totaled $821,000. The change in total accrued warranty reserve from March 31, 2014 to September 30, 2014 was primarily due to an increase in the number of instruments in standard warranty during the six months ended September 30, 2014.

Management periodically evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. If an unusual performance rate related to warranty claims is noted, an additional warranty accrual may be assessed and recorded when a failure event is probable and the cost can be reasonably estimated. We review the historical warranty cost trends and analyze the adequacy of the ending accrual balance of warranty reserves each quarter. The determination of warranty reserves requires us to make estimates of the estimated product failure rate,

expected costs to repair or replace the instruments and to replace defective reagent discs under warranty. If actual repair or replacement costs of instruments or replacement costs of reagent discs differ significantly from our estimates, adjustments to cost of revenues may be required. Additionally, if factors change and we revise our assumptions on the product failure rate of instruments or reagent discs, then our warranty reserves and cost of revenues could be materially impacted in the quarter of such revision, as well as in following quarters.

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

Valuation of Long-Lived Assets. We evaluate the carrying value of our long-lived assets, such as property and equipment and amortized intangible assets, whenever events or changes in business circumstances or our planned use of long-lived assets indicate that the carrying amount of an asset may not be fully recoverable or their useful lives are no longer appropriate. We look to current and future profitability, as well as current and future undiscounted cash flows, excluding financing costs, as primary indicators of recoverability. An impairment loss would be recognized when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposal is less than the carrying amount. If impairment is determined to exist, any related impairment loss is calculated based on fair value and long-lived assets are written down to their respective fair values. We did not recognize any impairment charges on long-lived assets during the three and six months ended September 30, 2014 and 2013.

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Intangible Assets. Intangible assets, consisting of licenses and other rights acquired from third parties, are presented at cost, net of accumulated amortization. The intangible assets are amortized using the straight-line method over their estimated useful life, which approximates the economic benefit. If our underlying assumptions regarding the estimated useful life of an intangible asset change, then the amortization period, amortization expense and the carrying value for such asset would be adjusted accordingly, and could result in a material change in the amortization expense and the carrying value for such asset.

Income Taxes. We account for income taxes using the liability method under which deferred tax assets and liabilities are determined based on the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amounts expected to be recovered.

We recognize and measure benefits for uncertain tax positions using a two-step approach. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of evidence indicates that it is more likely than not that the tax position will be sustained upon audit, including resolution of any related appeals or litigation processes. For tax positions that are more likely than not to be sustained upon audit, the second step is to measure the tax benefit as the largest amount that is more than 50 percent likely to be realized upon settlement. Significant judgment is required to evaluate uncertain tax positions. At September 30, 2014 and March 31, 2014, we had no significant uncertain tax positions. Our policy is to include interest and penalties related to gross unrecognized tax benefits within our provision for income taxes. During the three and six months ended September 30, 2014 and 2013, we did not recognize any interest or penalties related to uncertain tax positions in the condensed consolidated statements of income, and at September 30, 2014 and March 31, 2014, we had no accrued interest or penalties.

Share-Based Compensation Expense. We account for share-based compensation arrangements using the fair value method. We recognize share-based compensation expense, net of an estimated forfeiture rate, over the requisite service period of the award to employees and directors. As required by fair value provisions of share-based compensation, employee share-based compensation expense recognized is calculated over the requisite service period of the awards and reduced for estimated forfeitures. The forfeiture rate is estimated based on historical data of our share-based compensation awards that are granted and cancelled prior to vesting and upon historical experience of employee turnover. Changes in estimated forfeiture rates and differences between estimated forfeiture rates and actual experience may result in significant, unanticipated increases or decreases in share-based compensation expense from period to period. To the extent we revise our estimate of the forfeiture rate in the future, our share-based compensation expense could be materially impacted in the quarter of revision, as well as in following quarters.

Prior to fiscal 2007, we granted stock option awards to employees and directors as part of our share-based compensation program. We have not granted any stock options since the beginning of fiscal 2007. We have recognized compensation expense for stock options granted during the requisite service period of the stock option. As of September 30, 2014, we had no unrecognized compensation expense related to stock options granted.

Since fiscal 2007, we have granted restricted stock unit awards to employees and directors as part of our share-based compensation program. Restricted stock unit awards to consultants were not significant. Awards of restricted stock units are issued at no cost to the recipient and may have time-based vesting criteria, or a combination of time-based and performance-based vesting criteria, as described below.

The fair value of restricted stock unit awards with only time-based vesting terms, which we refer to as restricted stock unit awards (time vesting), used in our expense recognition method is measured based on the number of shares granted and the closing market price of our common stock on the date of grant. The share-based compensation expense is reduced for an estimate of the restricted stock unit awards that are expected to be forfeited. The forfeiture

estimate is based on historical data and other factors. In subsequent periods, if actual forfeitures differ from those estimates, an adjustment to share-based compensation expense will be recognized at that time. As a result, if factors change and we use different assumptions, our share-based compensation expense could be materially different in the future.

We also began granting restricted stock unit awards subject to performance vesting criteria, which we refer to as restricted stock unit awards (performance vesting), to our executive officers starting in fiscal 2013. Restricted stock unit awards (performance vesting) consist of the right to receive shares of common stock, subject to achievement of time-based criteria and certain corporate performance-related goals over a specified period, as established by the Compensation Committee of our Board of Directors (the "Compensation Committee"). For restricted stock units subject to performance vesting, we recognize any related share-based compensation expense ratably over the service period based on the most probable outcome of the performance condition. The fair value of our restricted stock unit awards (performance vesting) used in our expense recognition method is measured based on the number of shares granted, the closing market price of our common stock on the date of grant and an estimate of the probability of the achievement of the performance goals. The amount of share-based compensation expense recognized in any one period can vary based on the attainment or expected attainment of the performance goals. If such performance goals are not ultimately met, no compensation expense is recognized and any previously recognized compensation expense is reversed.

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Fiscal 2014 Performance RSUs. In April 2013, the Compensation Committee approved the grant of restricted stock unit awards (performance vesting) for 129,000 shares of common stock to our executive officers that also contained both time-based and performance-based vesting terms (the "FY2014 Performance RSUs"). The aggregate estimated grant date fair value of the FY2014 Performance RSUs was $5.5 million, or $42.43 per share, based on the closing market price of our common stock on the date of grant. The FY2014 Performance RSUs would have vested only if both of the following criteria were satisfied: (1) our consolidated income from operations for the fiscal year ended March 31, 2014, as certified by the Compensation Committee, was in excess of the applicable target amount described below; and (2) the recipient remained in the service of the Company until the applicable vesting date set forth as follows:

- 25% shares issuable upon settlement of FY2014 Performance RSUs upon satisfying 90% of target of consolidated income from operations for the year ended March 31, 2014 and time-based vesting on April 29, 2016;
- 25% shares issuable upon settlement of FY2014 Performance RSUs upon satisfying 90% of target of consolidated income from operations for the year ended March 31, 2014 and time-based vesting on April 29, 2017;
- 25% shares issuable upon settlement of FY2014 Performance RSUs upon satisfying 100% of target of consolidated income from operations for the year ended March 31, 2014 and time-based vesting on April 29, 2016; and
- 25% shares issuable upon settlement of FY2014 Performance RSUs upon satisfying 100% of target of consolidated income from operations for the year ended March 31, 2014 and time-based vesting on April 29, 2017.

At March 31, 2014, we reviewed each of the underlying performance targets related to the outstanding FY2014 Performance RSUs and determined that it was not probable that the FY2014 Performance RSUs would vest and as a result did not record share-based compensation related to these awards during fiscal 2014. On April 23, 2014, the Compensation Committee determined that the Company's consolidated income from operations for fiscal 2014 was below 90% of target and, accordingly, the FY2014 Performance RSUs did not vest and were cancelled.

Fiscal 2015 Performance RSUs. In April 2014, the Compensation Committee approved the grant of restricted stock unit awards (performance vesting) for 172,000 shares of common stock to our executive officers that also contained both time-based and performance-based vesting terms (the "FY2015 Performance RSUs"). The aggregate estimated grant date fair value of the FY2015 Performance RSUs was $7.0 million, or $40.82 per share, based on the closing market price of our common stock on the date of grant. The FY2015 Performance RSUs will vest only if both of the following criteria are satisfied: (1) our consolidated income from operations for the fiscal year ending March 31, 2015, as certified by the Compensation Committee, is in excess of the applicable target amount described below; and (2) the recipient remains in the service of the Company until the applicable vesting date set forth as follows:

- 25% shares issuable upon settlement of FY2015 Performance RSUs upon satisfying 90% of target of consolidated income from operations for the year ending March 31, 2015 and time-based vesting on April 28, 2017;
- 25% shares issuable upon settlement of FY2015 Performance RSUs upon satisfying 90% of target of consolidated income from operations for the year ending March 31, 2015 and time-based vesting on April 28, 2018;
- 25% shares issuable upon settlement of FY2015 Performance RSUs upon satisfying 100% of target of consolidated income from operations for the year ending March 31, 2015 and time-based vesting on April 28, 2017; and
- 25% shares issuable upon settlement of FY2015 Performance RSUs upon satisfying 100% of target of consolidated income from operations for the year ending March 31, 2015 and time-based vesting on April 28, 2018.

During the three and six months ended September 30, 2014, we recorded share-based compensation expense related to the portion of the FY2015 Performance RSUs, as we determined that it was probable that the performance targets would be met. We will assess the probability of the performance targets at the end of each quarter.

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Share-based compensation expense resulted in a material impact on our earnings per share and on our condensed consolidated financial statements for fiscal 2014 and during the three and six months ended September 30, 2014. The impact of share-based compensation expense on our condensed consolidated financial results is disclosed in Note 10, "Equity Compensation Plans and Share-Based Compensation" in the Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q. We expect that share-based compensation will materially impact our consolidated financial statements in the foreseeable future.

RESULTS OF OPERATIONS

Total Revenues

Revenues by Geographic Region and by Product and Service Category. Revenues by geographic region based on customer location and revenues by product and service category during the three and six months ended September 30, 2014 and 2013 were as follows (in thousands, except percentages):

	Three Months Ended September 30,				Six Months Ended September 30,			
Revenues by Geographic Region	2014	2013	Dollar Change	Percent Change	2014	2013	Dollar Change	Percent Change
North America	$44,511	$37,320	$7,191	19 %	$82,851	$71,972	$10,879	15 %
Percentage of total revenues	83 %	81 %			82 %	81 %		
Europe	7,244	6,446	798	12 %	14,528	12,998	1,530	12 %
Percentage of total revenues	13 %	14 %			14 %	15 %		
Asia Pacific and rest of the world	2,188	2,085	103	5 %	4,041	4,050	(9)	<(1)%
Percentage of total revenues	4 %	5 %			4 %	4 %		
Total revenues	$53,943	$45,851	$8,092	18 %	$101,420	$89,020	$12,400	14 %

	Three Months Ended September 30,				Six Months Ended September 30,			
Revenues by Product and Service Category	2014	2013	Dollar Change	Percent Change	2014	2013	Dollar Change	Percent Change
Instruments(1)	$10,105	$13,537	$(3,432)	(25)%	$17,699	$22,212	$(4,513)	(20)%
Percentage of total revenues	19 %	29 %			18 %	25 %		
Consumables(2)	38,138	28,699	9,439	33 %	72,424	59,298	13,126	22 %
Percentage of total revenues	71 %	63 %			71 %	67 %		
Other products and services(3)	5,663	3,577	2,086	58 %	11,223	7,435	3,788	51 %
Percentage of total revenues	10 %	8 %			11 %	8 %		
Product and service revenues, net	53,906	45,813	8,093	18 %	101,346	88,945	12,401	14 %
Percentage of total revenues	100 %	100 %			100 %	100 %		
	37	38	(1)	(3)%	74	75	(1)	(1)%

Development and licensing revenue										
Percentage of total revenues	<1 %	<1 %				<1 %	<1 %			
Total revenues	$53,943	$45,851	$8,092	18	%	$101,420	$89,020	$12,400	14	%

(1) Instruments include chemistry analyzers, hematology instruments, VSpro specialty analyzers and i-STAT analyzers.

(2) Consumables include reagent discs, hematology reagent kits, VSpro specialty cartridges, i-STAT cartridges and rapid tests.

(3) Other products and services include veterinary reference laboratory diagnostic and consulting services.

Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013

North America. During the three months ended September 30, 2014, total revenues in North America increased by 19%, or $7.2 million, as compared to the same period in fiscal 2014. The change in total revenues in North America was primarily attributable to the following:

- Total revenues from our Piccolo chemistry analyzers and medical reagent discs in North America increased by 1%, or $68,000, primarily due to an increase in the sales volume of medical reagent discs sold to Abbott, partially offset by a decrease in the sales volume of Piccolo chemistry analyzers sold to Abbott.

- Total sales of our VetScan chemistry analyzers and veterinary reagent discs in North America increased by 45%, or $6.8 million, primarily due to (a) sales of VetScan chemistry analyzers to VCA's Animal Hospitals resulting from a product supply agreement that we entered into in May 2014 and (b) an increase in the sales volume of veterinary reagent discs due to an expanded installed base.

- Total sales of our VetScan hematology instruments and hematology reagent kits in North America decreased by 25%, or $1.6 million, primarily due to lower sales of VetScan hematology instruments sold to MWI to balance the inventory level in the distribution channel, partially offset by an increase in the sales volume of hematology reagent kits due to an expanded installed base.

- Total sales of our VetScan VSpro specialty analyzers and related consumables, VetScan i STAT analyzers and related consumables and VetScan rapid tests in North America decreased by 2%, or $125,000, primarily due to lower sales of VetScan i STAT analyzers sold to MWI to balance the inventory level in the distribution channel, partially offset by an increase in the sales volume of VetScan rapid tests sold to MWI.

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- Other product and service revenues in North America increased by 61%, or $2.1 million, primarily attributable to an increase in service revenues from veterinary reference laboratory diagnostic and consulting services provided by AVRL due to an expanded customer base.

Europe. During the three months ended September 30, 2014, total revenues in Europe increased by 12%, or $798,000, as compared to the same period in fiscal 2014. Revenues from Piccolo chemistry analyzers and medical reagent discs increased by 20%, or $292,000, primarily due to an increase in the sales volume of medical reagent discs sold to various distributors. Revenues from VetScan chemistry analyzers and veterinary reagent discs increased by 11%, or $448,000, primarily due to an increase in the sales volume of veterinary reagent discs sold to a distributor.

Asia Pacific and rest of the world. During the three months ended September 30, 2014, the change in total revenues in Asia Pacific and rest of the world was not significant, as compared to the same period in fiscal 2014.

Significant concentrations. During the three months ended September 30, 2014 and 2013, one distributor in the United States, MWI, accounted for 19% and 22%, respectively, of our total worldwide revenues.

Six Months Ended September 30, 2014 Compared to Six Months Ended September 30, 2013

North America. During the six months ended September 30, 2014, total revenues in North America increased by 15%, or $10.9 million, as compared to the same period in fiscal 2014. The change in total revenues in North America was primarily attributable to the following:

- Total revenues from our Piccolo chemistry analyzers and medical reagent discs in North America increased by 13%, or $1.2 million, primarily due to an increase in the sales volume of medical reagent discs sold to Abbott.

- Total sales of our VetScan chemistry analyzers and veterinary reagent discs in North America increased by 31%, or $9.9 million, primarily due to (a) sales of VetScan chemistry analyzers to the U.S. government in the first quarter of fiscal 2015, (b) sales of VetScan chemistry analyzers to VCA's Animal Hospitals in the second quarter of fiscal 2015 resulting from our product supply agreement that we entered into in May 2014 and (c) an increase in the sales volume of veterinary reagent discs due to an expanded installed base.

- Total sales of our VetScan hematology instruments and hematology reagent kits in North America decreased by 22%, or $2.3 million, primarily due to lower sales of VetScan hematology instruments sold to MWI to balance the inventory level in the distribution channel, partially offset by an increase in the sales volume of hematology reagent kits due to an expanded installed base.

- Total sales of our VetScan VSpro specialty analyzers and related consumables, VetScan i STAT analyzers and related consumables and VetScan rapid tests in North America decreased by 12%, or $1.7 million, primarily due to lower sales of VetScan i STAT analyzers sold to MWI to balance the inventory level in the distribution channel, partially offset by an increase in the sales volume of VetScan rapid tests sold to MWI.

- Other product and service revenues in North America increased by 54%, or $3.8 million, primarily attributable to an increase in service revenues from veterinary reference laboratory diagnostic and consulting services provided by AVRL due to an expanded customer base.

Europe. During the six months ended September 30, 2014, total revenues in Europe increased by 12%, or $1.5 million, as compared to the same period in fiscal 2014. Revenues from Piccolo chemistry analyzers and medical reagent discs increased by 10%, or $320,000, primarily due to an increase in the sales volume of medical reagent discs sold to various distributors during the second quarter of fiscal 2015. Revenues from VetScan chemistry analyzers and veterinary reagent discs increased by 14%, or $1.2 million, primarily due to an increase in the sales volume of

veterinary reagent discs sold to two distributors, partially offset by lower average selling prices of VetScan chemistry analyzers sold during the first quarter of fiscal 2015.

Asia Pacific and rest of the world. During the six months ended September 30, 2014, the change in total revenues in Asia Pacific and rest of the world was not significant, as compared to the same period in fiscal 2014.

Significant concentrations. During the six months ended September 30, 2014 and 2013, one distributor in the United States, MWI, accounted for 17% and 22%, respectively, of our total worldwide revenues.

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Segment Results

Total Revenues, Cost of Revenues and Gross Profit by Segment. We identify our reportable segments as those customer groups that represent more than 10% of our combined revenue or gross profit or loss of all reported operating segments. We manage our business on the basis of the following two reportable segments: (i) the medical market and (ii) the veterinary market, which are based on the products sold and services provided by market and customer group.

Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013

The following table presents revenues, cost of revenues, gross profit and percentage of revenues by operating segments and from certain unallocated items for the three months ended September 30, 2014 and 2013 (in thousands, except percentages):

	Three Months Ended September 30,				Change	
	2014	Percent of Revenues(1)	2013	Percent of Revenues(1)	Dollar Change	Percent Change
Revenues:						
Medical Market	$7,616	100 %	$7,177	100 %	$439	6 %
Percentage of total revenues	14 %		16 %			
Veterinary Market	45,568	100 %	37,915	100 %	7,653	20 %
Percentage of total revenues	85 %		83 %			
Other(2)	759		759		-	- %
Percentage of total revenues	1 %		1 %			
Total revenues	53,943		45,851		8,092	18 %
Cost of revenues:						
Medical Market	4,053	53 %	3,999	56 %	54	1 %
Veterinary Market	21,427	47 %	19,961	53 %	1,466	7 %
Other(2)	31		19		12	63 %
Total cost of revenues	25,511		23,979		1,532	6 %
Gross profit:						
Medical Market	3,563	47 %	3,178	44 %	385	12 %
Veterinary Market	24,141	53 %	17,954	47 %	6,187	34 %
Other(2)	728		740		(12)	(2)%
Gross profit	$28,432		$21,872		$6,560	30 %

(1) The percentage reported is based on revenues by operating segment.
(2) Represents unallocated items, not specifically identified to any particular business segment.

Medical Market

Revenues for Medical Market Segment

During the three months ended September 30, 2014, total revenues in the medical market increased by 6%, or $439,000, as compared to the same period in fiscal 2014. The change in the medical market segment was primarily attributable to the following:

· Total revenues from Piccolo chemistry analyzers decreased by 10%, or $191,000, during the three months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to a decrease in the sales

volume of Piccolo chemistry analyzers sold to Abbott in North America.

- Total revenues from medical reagent discs increased by 14%, or $698,000, during the three months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to an increase in the sales volume of medical reagent discs sold to Abbott in North America and various distributors in Europe.

Gross Profit for Medical Market Segment

Gross profit for the medical market segment increased by 12%, or $385,000, during the three months ended September 30, 2014, as compared to the same period in fiscal 2014. Gross profit percentages for the medical market segment during the three months ended September 30, 2014 and 2013 were 47% and 44%, respectively. In absolute dollars and as a percentage of total revenues, the increase in gross profit was primarily due to higher unit sales of medical reagent discs.

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Veterinary Market

Revenues for Veterinary Market Segment

During the three months ended September 30, 2014, total revenues in the veterinary market increased by 20%, or $7.7 million, as compared to the same period in fiscal 2014. The change in the veterinary market segment was primarily attributable to the following:

- Total revenues from veterinary instruments decreased by 28%, or $3.2 million, during the three months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to lower sales of VetScan hematology instruments and VetScan i STAT analyzers sold to MWI to balance the inventory level in the distribution channel. These decreases were partially offset by sales of VetScan chemistry analyzers during the second quarter of fiscal 2015 to VCA's Animal Hospitals resulting from a product supply agreement that we entered into in May 2014.

- Total revenues from consumables in the veterinary market increased by 37%, or $8.7 million, during the three months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to (a) an increase in the sales volume of veterinary reagent discs and hematology reagent kits in North America due to an expanded installed base, (b) an increase in the sales volume of veterinary reagent discs sold to a distributor in Europe and (c) an increase in the sales volume of VetScan rapid tests in North America sold to MWI.

- Total revenues from other products and services in the veterinary market increased by 89%, or $2.2 million, during the three months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to an increase in service revenues from veterinary reference laboratory diagnostic and consulting services provided by AVRL in North America due to an expanded customer base.

Gross Profit for Veterinary Market Segment

Gross profit for the veterinary market segment increased by 34%, or $6.2 million, during the three months ended September 30, 2014, as compared to the same period in fiscal 2014. Gross profit percentages for the veterinary market segment during the three months ended September 30, 2014 and 2013 were 53% and 47%, respectively. In absolute dollars, the net increase in gross profit was primarily attributable to (a) higher unit sales of veterinary reagent discs and hematology reagent kits and (b) a reduction in cost of laboratory services per test and efficiency from an increase in volume of test requisitions. These increases were partially offset by lower unit sales of VetScan hematology instruments. The increase in gross profit percentage was primarily attributable to higher unit sales of veterinary reagent discs.

Other

Our other category primarily consists of products sold using our patented Orbos Discrete Lyophilization Process. The change in gross profit in our other category was not significant during the three months ended September 30, 2014, as compared to the same period in fiscal 2014.

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Six Months Ended September 30, 2014 Compared to Six Months Ended September 30, 2013

The following table presents revenues, cost of revenues, gross profit and percentage of revenues by operating segments and from certain unallocated items for the six months ended September 30, 2014 and 2013 (in thousands, except percentages):

	Six Months Ended September 30,				Change	
	2014	Percent of Revenues(1)	2013	Percent of Revenues(1)	Dollar Change	Percent Change
Revenues:						
Medical Market	$14,861	100 %	$13,215	100 %	$1,646	12 %
Percentage of total revenues	15 %		15 %			
Veterinary Market	84,935	100 %	74,286	100 %	10,649	14 %
Percentage of total revenues	84 %		83 %			
Other(2)	1,624		1,519		105	7 %
Percentage of total revenues	1 %		2 %			
Total revenues	101,420		89,020		12,400	14 %
Cost of revenues:						
Medical Market	7,897	53 %	7,293	55 %	604	8 %
Veterinary Market	41,151	48 %	38,909	52 %	2,242	6 %
Other(2)	68		54		14	26 %
Total cost of revenues	49,116		46,256		2,860	6 %
Gross profit:						
Medical Market	6,964	47 %	5,922	45 %	1,042	18 %
Veterinary Market	43,784	52 %	35,377	48 %	8,407	24 %
Other(2)	1,556		1,465		91	6 %
Gross profit	$52,304		$42,764		$9,540	22 %

(1) The percentage reported is based on revenues by operating segment.
(2) Represents unallocated items, not specifically identified to any particular business segment.

Medical Market

Revenues for Medical Market Segment

During the six months ended September 30, 2014, total revenues in the medical market increased by 12%, or $1.6 million, as compared to the same period in fiscal 2014. The change in the medical market segment was primarily attributable to the following:

- The change in total revenues from Piccolo chemistry analyzers during the six months ended September 30, 2014 was not significant as compared to the same period in fiscal 2014.

- Total revenues from medical reagent discs increased by 18%, or $1.7 million, during the six months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to an increase in the sales volume of medical reagent discs sold to Abbott in North America and various distributors in Europe.

Gross Profit for Medical Market Segment

Gross profit for the medical market segment increased by 18%, or $1.0 million, during the six months ended September 30, 2014, as compared to the same period in fiscal 2014. Gross profit percentages for the medical market segment during the six months ended September 30, 2014 and 2013 were 47% and 45%, respectively. In absolute dollars and as a percentage of total revenues, the increase in gross profit was primarily due to higher unit sales of medical reagent discs.

Veterinary Market

Revenues for Veterinary Market Segment

During the six months ended September 30, 2014, total revenues in the veterinary market increased by 14%, or $10.6 million, as compared to the same period in fiscal 2014. The change in the veterinary market segment was primarily attributable to the following:

- Total revenues from veterinary instruments decreased by 23%, or $4.5 million, during the six months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to (a) lower sales of VetScan hematology instruments and VetScan i STAT analyzers sold to MWI to balance the inventory level in the distribution channel and (b) lower average selling prices of VetScan chemistry analyzers sold in Europe during the first quarter of fiscal 2015. These decreases were partially offset by sales of VetScan chemistry analyzers to the U.S. government in the first quarter of fiscal 2015 and to VCA’s Animal Hospitals in the second quarter of fiscal 2015.

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- Total revenues from consumables in the veterinary market increased by 23%, or $11.5 million, during the six months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to (a) an increase in the sales volume of veterinary reagent discs and hematology reagent kits in North America due to an expanded installed base, (b) an increase in the sales volume of veterinary reagent discs sold to two distributors in Europe and (c) an increase in the sales volume of VetScan rapid tests in North America sold to MWI.

- Total revenues from other products and services in the veterinary market increased by 72%, or $3.7 million, during the six months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to an increase in service revenues from veterinary reference laboratory diagnostic and consulting services provided by AVRL in North America due to an expanded customer base.

Gross Profit for Veterinary Market Segment

Gross profit for the veterinary market segment increased by 24%, or $8.4 million, during the six months ended September 30, 2014, as compared to the same period in fiscal 2014. Gross profit percentages for the veterinary market segment during the six months ended September 30, 2014 and 2013 were 52% and 48%, respectively. In absolute dollars, the net increase in gross profit was primarily attributable to (a) higher unit sales of veterinary reagent discs and hematology reagent kits and (b) a reduction in cost of laboratory services per test and efficiency from an increase in volume of test requisitions. These increases were partially offset by lower unit sales of VetScan hematology instruments. The increase in gross profit percentage was primarily attributable to higher unit sales of veterinary reagent discs.

Other

The change in gross profit in our other category was not significant during the six months ended September 30, 2014, as compared to the same period in fiscal 2014.

Three and Six Months Ended September 30, 2014 Compared to Three and Six Months Ended September 30, 2013

Cost of Revenues

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

	Three Months Ended September 30,				Six Months Ended September 30,			
	2014	2013	Dollar Change	Percent Change	2014	2013	Dollar Change	Percent Change
Cost of revenues	$25,511	$23,979	$1,532	6 %	$49,116	$46,256	$2,860	6 %
Percentage of total revenues	47 %	52 %			48 %	52 %		

Cost of revenues includes the cost of materials, direct labor costs, costs associated with manufacturing, assembly, packaging, warranty repairs, test and quality assurance for our instruments and consumables and manufacturing overhead, including costs of personnel and equipment associated with manufacturing support. Additionally, cost of revenues includes cost of laboratory services for veterinary reference laboratory diagnostic and consulting services provided by AVRL.

The increase in cost of revenues, in absolute dollars, during the three months ended September 30, 2014, as compared to the same period in fiscal 2014, was primarily attributable to (a) an increase in the sales volume of VetScan chemistry analyzers and medical and veterinary reagent discs and (b) an increase in volume of laboratory test requisitions. These increases were partially offset by (a) lower unit sales of VetScan hematology instruments and (b) a reduction in cost of laboratory services per test and efficiency from an increase in volume of test requisitions. The

decrease in cost of revenues, as a percentage of total revenues, during the three months ended September 30, 2014, as compared to the same period in fiscal 2014, was primarily due to an increase in the sales volume of medical and veterinary reagent discs.

The increase in cost of revenues, in absolute dollars, during the six months ended September 30, 2014, as compared to the same period in fiscal 2014, was primarily attributable to (a) an increase in the sales volume of VetScan chemistry analyzers and medical and veterinary reagent discs and (b) an increase in volume of laboratory test requisitions. These increases were partially offset by (a) lower unit sales of VetScan hematology instruments and VetScan i- STAT analyzers and (b) a reduction in cost of laboratory services per test and efficiency from an increase in volume of test requisitions. The decrease in cost of revenues, as a percentage of total revenues, during the six months ended September 30, 2014, as compared to the same period in fiscal 2014, was primarily due to an increase in the sales volume of medical and veterinary reagent discs.

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Gross Profit

The following sets forth our gross profit for the periods indicated (in thousands, except percentages):

	Three Months Ended September 30,				Six Months Ended September 30,			
	2014	2013	Dollar Change	Percent Change	2014	2013	Dollar Change	Percent Change
Total gross profit	$28,432	$21,872	$6,560	30 %	$52,304	$42,764	$9,540	22 %
Total gross profit percentage	53 %	48 %			52 %	48 %		

Gross profit during the three months ended September 30, 2014 increased by 30%, or $6.6 million, as compared to the same period in fiscal 2014, primarily attributable to the following: (a) higher unit sales of medical and veterinary reagent discs and hematology reagent kits and (b) a reduction in costs of laboratory services per test and efficiency from an increase in volume of test requisitions. These increases were partially offset by lower unit sales of VetScan hematology instruments. The increase in gross profit percentage was primarily attributable to higher unit sales of medical and veterinary reagent discs.

Gross profit during the six months ended September 30, 2014 increased by 22%, or $9.5 million, as compared to the same period in fiscal 2014, primarily attributable to the following: (a) higher unit sales of medical and veterinary reagent discs and hematology reagent kits and (b) a reduction in costs of laboratory services per test and efficiency from an increase in volume of test requisitions. These increases were partially offset by lower unit sales of VetScan hematology instruments. The increase in gross profit percentage was primarily attributable to higher unit sales of medical and veterinary reagent discs.

Research and Development

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

	Three Months Ended September 30,				Six Months Ended September 30,			
	2014	2013	Dollar Change	Percent Change	2014	2013	Dollar Change	Percent Change
Research and development expenses	$4,232	$3,418	$ 814	24 %	$8,179	$6,591	$1,588	24 %
Percentage of total revenues	8 %	7 %			8 %	7 %		

Research and development expenses consist of personnel costs (including salaries, benefits and share-based compensation expense), consulting expenses and materials and related expenses associated with the development of new tests and test methods, clinical trials, product improvements and optimization and enhancement of existing products and expenses related to regulatory and quality assurance. Research and development expenses are primarily based on the project activities planned and the level of spending depends on budgeted expenditures. Research and development expenses for the periods presented above are related primarily to new product development and enhancement of existing products in both the medical and veterinary markets.

Research and development expenses increased during the three months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to an increase in employee bonus compensation expense due to meeting company performance targets. Share-based compensation expense included in research and development expenses during the three months ended September 30, 2014 and 2013 was $378,000 and $215,000, respectively.

Research and development expenses increased during the six months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to an increase in employee bonus compensation expense due to meeting company performance targets and expenses related to new product development and enhancement of existing products in both the medical and veterinary markets, including costs associated with our research and development diagnostic agreement with LamdaGen Corporation, which we entered into in fiscal 2014, to integrate LamdaGen's high-sensitivity Plasmonic ELISA technology on the reagent discs used with our chemistry analyzers. Share-based compensation expense included in research and development expenses during the six months ended September 30, 2014 and 2013 was $819,000 and $582,000, respectively.

We anticipate the dollar amount of research and development expenses to increase in fiscal 2015 from fiscal 2014 but remain consistent as a percentage of total revenues, as we complete new products and enhance existing products for both the medical and veterinary markets.

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Sales and Marketing

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

	Three Months Ended September 30,				Six Months Ended September 30,			
	2014	2013	Dollar Change	Percent Change	2014	2013	Dollar Change	Percent Change
Sales and marketing expenses	$11,476	$9,902	$1,574	16 %	$21,054	$19,930	$1,124	6 %
Percentage of total revenues	21 %	22 %			21 %	22 %		

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

Sales and marketing expenses increased during the three months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to an increase in employee bonus compensation expense due to meeting company performance targets. Share-based compensation expense included in sales and marketing expenses during the three months ended September 30, 2014 and 2013 was $701,000 and $595,000, respectively.

Sales and marketing expenses increased during the six months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to an increase in employee bonus compensation expense due to meeting company performance targets, partially offset by (a) a decrease in personnel-related expenses in the first quarter of fiscal 2015 primarily due to lower veterinary business headcount and (b) decreased costs related to promotional and marketing spending in the first quarter of fiscal 2015. Share-based compensation expense included in sales and marketing expenses during the six months ended September 30, 2014 and 2013 was $1.5 million and $1.3 million, respectively.

General and Administrative

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

	Three Months Ended September 30,				Six Months Ended September 30,			
	2014	2013	Dollar Change	Percent Change	2014	2013	Dollar Change	Percent Change
General and administrative expenses	$3,797	$2,853	$944	33 %	$6,705	$5,908	$797	13 %
Percentage of total revenues	7 %	6 %			7 %	7 %		

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

General and administrative expenses increased during the three months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to an increase in employee bonus compensation expense due to meeting company performance targets and other expenses to support our ongoing growth. Share-based compensation expense included in general and administrative expenses during the three months ended September 30, 2014 and 2013 was $1.0 million and $745,000, respectively.

General and administrative expenses increased during the six months ended September 30, 2014, as compared to the same period in fiscal 2014, primarily attributable to an increase in employee bonus compensation expense due to meeting company performance targets and other expenses to support our ongoing growth, partially offset by a decrease in share-based compensation related to adjustments for forfeiture estimates to reflect actual forfeitures when an award vested in the first quarter of fiscal 2015. Share-based compensation expense included in general and administrative expenses during the six months ended September 30, 2014 and 2013 was $1.4 million and $1.7 million, respectively.

Interest and Other Income (Expense), Net

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

	Three Months Ended September 30,			Six Months Ended September 30,		
	2014	2013	Dollar Change	2014	2013	Dollar Change
Interest and other income (expense), net	$(445)	$507	$ (952)	$(398)	$911	$(1,309)

Interest and other income (expense), net consists primarily of interest earned on cash and cash equivalents and investments, foreign currency exchange gains and losses and our equity in net income (loss) of an unconsolidated affiliate.

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Interest and other income (expense), net decreased during the three and six months ended September 30, 2014 as compared to the same period in fiscal 2014, primarily attributable to foreign currency exchange rate fluctuations.

Income Tax Provision

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Income tax provision	$3,082	$2,210	$5,853	$4,021
Effective tax rate	36 %	36 %	37 %	36 %

During the three months ended September 30, 2014 and 2013, our income tax provision was $3.1 million, based on an effective tax rate of 36%, and $2.2 million, based on an effective tax rate of 36%, respectively. The effective tax rate during the three months ended September 30, 2014, as compared to the three months ended September 30, 2013, was impacted by an elimination of federal research and development tax credits resulting from the expiration of the credit for expenses incurred after December 31, 2013, partially offset by an increase in federal tax benefits for qualified production activities.

During the six months ended September 30, 2014 and 2013, our income tax provision was $5.9 million, based on an effective tax rate of 37%, and $4.0 million, based on an effective tax rate of 36%, respectively. The increase in our effective tax rate during the six months ended September 30, 2014, as compared to the six months ended September 30, 2013, was primarily due to an elimination of federal research and development tax credits resulting from the expiration of the credit for expenses incurred after December 31, 2013.

We did not have any unrecognized tax benefits as of September 30, 2014 and March 31, 2014. During the three and six months ended September 30, 2014 and 2013, we did not recognize any interest or penalties related to unrecognized tax benefits.

LIQUIDITY AND CAPITAL RESOURCES

Cash, Cash Equivalents and Investments

The following table summarizes our cash, cash equivalents and short-term and long-term investments at September 30, 2014 and March 31, 2014 (in thousands, except percentages):

	September 30, 2014	March 31, 2014
Cash and cash equivalents	$84,594	$73,589
Short-term investments	20,844	29,102
Long-term investments	20,851	18,491
Total cash, cash equivalents and investments	$126,289	$121,182
Percentage of total assets	54 %	56 %

At September 30, 2014, we had net working capital of $153.0 million compared to $148.6 million at March 31, 2014.

Cash Flow Changes

Cash provided by (used in) operating, investing and financing activities for the six months ended September 30, 2014 and 2013 were as follows (in thousands):

	Six Months Ended September 30,	
	2014	2013
Net cash provided by operating activities	$16,365	$14,176
Net cash provided by investing activities	1,673	4,850
Net cash used in financing activities	(6,459)	(2,836)
Effect of exchange rate changes on cash and cash equivalents	(574)	346
Net increase in cash and cash equivalents	$11,005	$16,536

Cash and cash equivalents at September 30, 2014 were $84.6 million compared to $73.6 million at March 31, 2014. The increase in cash and cash equivalents during the six months ended September 30, 2014 was primarily due to net cash provided by operating activities of $16.4 million and proceeds from maturities and redemptions of investments of $19.2 million. The increase was partially offset by purchases of investments of $13.7 million, payments made for tax withholdings related to net share settlements of restricted stock units of $2.9 million, purchases of property and equipment of $3.9 million and payment of cash dividends totaling $4.5 million during the six months ended September 30, 2014.

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Cash Flows from Operating Activities

During the six months ended September 30, 2014, we generated $16.4 million in cash from operating activities, compared to $14.2 million during the six months ended September 30, 2013. The cash provided by operating activities during the six months ended September 30, 2014 was primarily the result of net income of $10.1 million, adjusted for the effects of non-cash adjustments including depreciation and amortization of $4.2 million and share-based compensation expense of $4.5 million. Additionally, during the six months ended September 30, 2014, we had non-cash adjustments related to excess tax benefits from share-based awards of $859,000.

Other changes in operating activities during the six months ended September 30, 2014 were as follows:

- Receivables, net increased by $7.1 million, from $29.2 million at March 31, 2014 to $36.4 million as of September 30, 2014, primarily due to higher sales during the second quarter of fiscal 2015.

- Inventories increased by $2.0 million, from $27.0 million at March 31, 2014 to $29.0 million as of September 30, 2014, primarily based on our projected sales plan.

- Prepaid expenses and other current assets increased by $1.5 million, from $2.5 million at March 31, 2014 to $4.0 million as of September 30, 2014, primarily attributable to an increase in prepaid taxes due to the timing of estimated income tax payments.

- Net current deferred tax assets increased by $1.5 million, from $4.5 million at March 31, 2014 to $6.0 million as of September 30, 2014, primarily as a result of the timing for the deduction of share-based compensation, reserves, accruals, depreciation and amortization.

- Accounts payable increased by $4.0 million, from $6.1 million at March 31, 2014 to $10.1 million as of September 30, 2014, primarily due to the timing and payment of services and inventory purchases.

- Accrued payroll and related expenses increased by $4.1 million, from $4.7 million at March 31, 2014 to $8.8 million as of September 30, 2014, primarily due to an increase in accrued bonus at September 30, 2014 because qualifiers for bonus payments were met in the second quarter of fiscal 2015.

- Accrued taxes decreased by $380,000, from $1.1 million at March 31, 2014 to $764,000 as of September 30, 2014, primarily due to the timing of estimated income tax payments.

- Other accrued liabilities increased by $2.5 million, from $3.1 million at March 31, 2014 to $5.6 million as of September 30, 2014, primarily due to higher accruals for customer incentive programs during the quarter ended September 30, 2014.

- As of September 30, 2014 and March 31, 2014, the current portion of deferred revenue was $1.2 million and $1.2 million, respectively, and the non-current portion of deferred revenue was $3.6 million and $4.0 million, respectively. Net current and non-current deferred revenue decreased by $441,000 from March 31, 2014 to September 30, 2014, primarily attributable to deferred revenue recognized ratably over the life of extended maintenance contracts offered to customers in the form of free services in connection with the sale of our instruments. In October 2013, we prospectively changed the standard warranty obligations on certain instruments sold from three to five years, which resulted in a decrease in maintenance contracts offered to customers in the form of free services in connection with the sale of our instruments.

- As of September 30, 2014 and March 31, 2014, the current portion of warranty reserve was $1.2 million and $1.0 million, respectively, and the non-current portion of warranty reserve was $992,000 and $821,000, respectively. The

increase in current and non-current warranty reserve from March 31, 2014 to September 30, 2014 was primarily due to an increase in the number of instruments in standard warranty during the six months ended September 30, 2014. Warranty reserve is primarily based on (a) the number of instruments in standard warranty, estimated product failure rates and estimated repair costs and (b) an estimate of defective reagent discs and replacement costs of reagent discs. In October 2013, we prospectively changed the standard warranty obligations on certain instruments from three to five years. The increase in the standard warranty obligation did not result in a material impact on our warranty reserves or cost of revenues during the period. Management periodically evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. If an unusual performance rate related to warranty claims is noted, an additional warranty accrual may be assessed and recorded when a failure event is probable and the cost can be reasonably estimated.

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

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Cash Flows from Investing Activities

Net cash provided by investing activities during the six months ended September 30, 2014 totaled $1.7 million, compared to net cash provided by investing activities of $4.9 million during the six months ended September 30, 2013. Changes in investing activities were as follows:

- Cash provided by proceeds from maturities and redemptions of investments in certificates of deposit, commercial paper and corporate bonds totaled $19.2 million during the six months ended September 30, 2014. Cash used to purchase investments in certificates of deposit, commercial paper and corporate bonds totaled $13.7 million during the six months ended September 30, 2014.

- Our capital expenditures totaled $3.9 million during the six months ended September 30, 2014, primarily to increase our manufacturing capacity and support our growth in our medical and veterinary business in North America. We expect to continue to make significant capital expenditures as necessary in the normal course of our business.

Cash Flows from Financing Activities

Net cash used in financing activities during the six months ended September 30, 2014 totaled $6.5 million, compared to net cash used in financing activities of $2.8 million during the six months ended September 30, 2013. The changes during the six months ended September 30, 2014 were primarily due to payments made for tax withholdings related to net share settlements of restricted stock units of $2.9 million and a cash dividend payment of $4.5 million. In April 2014, our Board of Directors declared a cash dividend of $0.10 per share on our outstanding common stock to all shareholders of record as of the close of business on June 3, 2014. The dividend totaled $2.2 million and was paid on June 17, 2014. In July 2014, our Board of Directors declared a cash dividend of $0.10 per share on our outstanding common stock to all shareholders of record as of the close of business on September 3, 2014. The dividend totaled $2.3 million and was paid on September 17, 2014. Additionally, during the six months ended September 30, 2014, we did not purchase any shares pursuant to our share repurchase program described below.

Dividend

In April 2014, our Board of Directors declared a cash dividend of $0.10 per share on our outstanding common stock to all shareholders of record as of the close of business on June 3, 2014. The dividend totaled $2.2 million and was paid on June 17, 2014. In July 2014, our Board of Directors declared a cash dividend of $0.10 per share on our outstanding common stock to all shareholders of record as of the close of business on September 3, 2014. The dividend totaled $2.3 million and was paid on September 17, 2014. In October 2014, our Board of Directors declared a cash dividend of $0.10 per share on our outstanding common stock to be paid on December 16, 2014 to all shareholders of record as of the close of business on November 17, 2014. We anticipate paying an additional quarterly dividend during our fourth quarter of fiscal 2015. However, such future declarations of quarterly dividends and the establishment of future record and payment dates are subject to the final determination of our Board of Directors.

Share Repurchase Program

Between August 2011 and January 2012, the Board of Directors authorized the repurchase of up to a total of $55.0 million of our common stock. In July 2013, the Board of Directors approved a $12.3 million increase to our existing share repurchase program to a total of $67.3 million. As of September 30, 2014, $37.0 million was available to purchase common stock under our share repurchase program. Since the share repurchase program began, through September 30, 2014, we have repurchased 1.3 million shares of our common stock at a total cost of $30.3 million, including commission expense. During the three and six months ended September 30, 2014 and 2013, we did not repurchase any shares of our common stock. The repurchases are made from time to time on the open market at prevailing market prices or in negotiated transactions off the market. Repurchased shares are retired.

Financial Condition

We believe that our cash and cash equivalents, investments and expected cash flows from operations will be sufficient to fund our operations, capital requirements, share repurchase program and anticipated quarterly dividends for at least the next twelve months. Our future capital requirements will largely depend upon the increased customer demand and market acceptance of our point-of-care blood analyzer products and of our Abaxis Veterinary Reference Laboratories. However, our sales for any future periods are not predictable with a significant degree of certainty. Regardless, we may seek to raise additional funds to pursue strategic opportunities.

Contractual Obligations

Purchase Commitments. We have purchase commitments, consisting of supply and inventory related agreements, totaling approximately $11.2 million as of September 30, 2014. These purchase order commitments include our purchase obligations to purchase VSpro specialty analyzers and related cartridges from SMB of Denmark through calendar year 2016 and obligations to purchase Diatron hematology instruments from Diatron of Hungary through fiscal year 2015.

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Notes Payable. We have a ten year loan agreement with the Community Redevelopment Agency of the City of Union City ("the Agency") whereby the Agency provides us with an unsecured loan of up to $1.0 million, primarily to purchase capital equipment. The loan was effective January 2011, bears interest at 5.0% and is payable quarterly. As of September 30, 2014, our short-term and long-term notes payable balances were $100,000 and $531,000, respectively, and we recorded the short-term balance in "Other accrued liabilities" on the condensed consolidated balance sheets. The entire outstanding balance of the note is payable in full on the earlier of: (i) December 2020, or (ii) the date Abaxis ceases operations in Union City, California. The Agency also has the right to accelerate the maturity date and declare all balances immediately due and payable upon the event of default as defined in the loan agreement. We evaluate covenants in our loan agreement on a quarterly basis, and we were in compliance with such covenants as of September 30, 2014.

In accordance with the terms of the loan agreement, the Agency will provide Abaxis with an annual credit that can be applied against the accrued interest and outstanding principal balance on a quarterly basis. The Agency determines the annual credit based on certain taxes paid by Abaxis to the City of Union City, California for a specified period, as defined in the loan agreement. We anticipate that our annual credits from the Agency will be used to fully repay our notes payable due to the Agency. We may carry forward unused quarterly credits to apply against our outstanding balance in a future period. Credits applied to repay our notes payable and accrued interest are recorded in "Interest and other income (expense), net" on the condensed consolidated statements of income.

Patent Licensing Agreement. Effective January 2009, we entered into a license agreement with Alere. Under our license agreement, we licensed co-exclusively certain worldwide patent rights related to lateral flow immunoassay technology in the field of animal health diagnostics in the professional marketplace. The license agreement provides that Alere shall not grant any future rights to any third parties under its current lateral flow patent rights in the animal health diagnostics field in the professional marketplace. The license agreement enables us to develop and market products under rights from Alere to address animal health and laboratory animal research markets.

In exchange for the license rights, we (i) paid an up-front license fee of $5.0 million to Alere in January 2009, (ii) agreed to pay royalties during the term of the agreement, based solely on sales of products in a jurisdiction country covered by valid and unexpired claims in that jurisdiction under the licensed Alere patent rights, and (iii) agreed to pay a yearly minimum license fee of between $500,000 to $1.0 million per year, which fee will be creditable against any royalties due during such calendar year. The royalties, if any, are payable through the date of the expiration of the last valid patent licensed under the agreement that includes at least one claim in a jurisdiction covering products we sell in that jurisdiction. The yearly minimum fees are payable for so long as we desire to maintain exclusivity under the agreement.

Contingencies

On October 1, 2012, St. Louis Police Retirement System, a purported shareholder of Abaxis, filed a lawsuit against certain officers and each of the directors of the Company in the United States District Court for the Northern District of California alleging, among other things, that the directors violated Section 14(a) of the Securities Exchange Act of 1934 and breached their fiduciary duties by allegedly failing to disclose material information in our 2010 proxy statement, breached their fiduciary duties by allegedly violating the terms of our 2005 Equity Incentive Plan, and breached their fiduciary duties by failing to disclose alleged material information in our 2012 proxy statement regarding (1) the events leading up to our proposal to amend the 2005 Equity Incentive Plan to eliminate the limit on the number of shares that may be issued pursuant to restricted stock units, and (2) the effects of the proposed amendment on certain settled and outstanding restricted stock units. The plaintiff seeks, among other things, damages, disgorgement and attorney's fees. In addition, the plaintiff sought, and on October 23, 2012, the court issued, an order preliminarily enjoining our shareholder vote on Proposal 2 in our 2012 proxy statement, regarding an amendment to the 2005 Equity Incentive Plan, until such time as additional disclosures could be made. We filed with the SEC and mailed to shareholders supplemental proxy materials approved by the court, the injunction was lifted and

our shareholders approved the proposal to amend our 2005 Equity Incentive Plan. A hearing on defendants' motion to dismiss the claims was held on May 7, 2013.

On October 1, 2013, before the court ruled on the motions to dismiss, the parties notified the court that they had reached a settlement of the lawsuit. On January 16, 2014, the parties entered into a Stipulation of Settlement, and the following day, the plaintiff filed a motion for preliminary approval. On April 15, 2014, the court issued an order granting preliminary approval of the settlement. A hearing on the motion for final approval of the settlement and the plaintiff's petition for attorney's fees was held on June 17, 2014. On August 12, 2014, the Court issued a final judgment order, among other things, approving the settlement. Pursuant to the settlement, the parties have agreed that the claims against the defendants will be dismissed with prejudice and will be granted the release of certain known or unknown claims that have been or could have been brought later in the court arising out of the same allegations. We have also agreed that we will adopt certain corporate governance measures, such measures to be in effect for at least five years. The court also awarded $579,430 in attorney's fees and costs to plaintiff's counsel, which was paid by the Company's insurance. We believe that the attorney's fees that were awarded to the plaintiff's counsel did not have a material adverse effect on Abaxis, our consolidated financial position or our results of operations.

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We are involved from time to time in various litigation matters in the normal course of business. There can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows.

Off-Balance Sheet Arrangements

As of September 30, 2014, we did not have any off-balance sheet arrangements, as defined in Item 303 of Regulation S-K promulgated under the Securities Act of 1933. In addition, we identified no variable interests in any variable interest entities.

RECENT ACCOUNTING PRONOUNCEMENTS

A discussion of recent accounting pronouncements is included in Note 2 of the Notes to Condensed Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our financial position is exposed to a variety of risks related to changes in interest rates and foreign currency rates and investment in a privately held company. As a matter of management policy, we do not currently enter into transactions involving derivative financial instruments. In the event we do enter into such transactions in the future, such items will be accounted for in accordance with Accounting Standards Codification 815, “Derivatives and Hedging.”

Interest Rate Risk

Our investment objective is to invest excess cash in cash equivalents and in various types of investments to maximize yields without significantly increased risk. At September 30, 2014, our short-term and long-term investments totaled $20.8 million and $20.9 million, respectively, consisting of investments in certificates of deposit, commercial paper, corporate bonds and municipal bonds. For our securities classified as available-for-sale, we record these investments at fair market value with unrealized gains or losses resulting from changes in fair value reported as a separate component of accumulated other comprehensive income (loss), net of any tax effects, in shareholders’ equity. The fair value of our investment portfolio is subject to change as a result of changes in market interest rates and investment risk related to the issuers’ credit worthiness. Changes in market interest rates would not be expected to have a material impact on the fair value of these assets at September 30, 2014, as the assets consisted of highly liquid securities.

We are exposed to the impact of interest rate changes with respect to our short-term and long-term investments. As of September 30, 2014, we had $31.4 million in investments classified as held-to-maturity and carried at amortized cost. We have the ability to hold the investments classified as held-to-maturity in our investment portfolio at September 30, 2014 until maturity and therefore, we believe we have no material exposure to interest rate risk. As of September 30, 2014, our investments classified as available-for-sale totaled $10.3 million, consisting primarily of fixed income securities and thus changes in interest rates would not have a material effect on our business, operating results or financial condition. We have not experienced any significant loss on our investment portfolio during fiscal 2014 or during the six months ended September 30, 2014.

Foreign Currency Rate Fluctuations

We operate primarily in the United States and a majority of our revenues, cost of revenues, operating expenses and capital purchasing activities are transacted in U.S. dollars. However, we are exposed to foreign currency risks that arise from normal business operations. These risks are primarily related to remeasuring local currency balances and results of our subsidiary, Abaxis Europe GmbH, into U.S. dollars and third-party transactions denominated in a

currency other than the U.S. dollar.

Abaxis Europe GmbH, our wholly-owned subsidiary since July 2008, markets, promotes and distributes diagnostic systems for medical and veterinary uses. Abaxis Europe GmbH's functional currency is in U.S. dollars. Foreign currency denominated account balances of our subsidiary are remeasured into U.S. dollars at the end-of-period exchange rates for monetary assets and liabilities, and historical exchange rates for nonmonetary assets. The effects of foreign currency transactions, and of remeasuring the financial condition into the functional currency, resulted in foreign currency gains and losses, which were included in "Interest and other income (expense), net" on our condensed consolidated statements of income. For our sales denominated in foreign currencies, we are exposed to foreign currency exchange rate fluctuations on revenue and collection of receivables.

Our most significant third-party transactions are inventory purchases of hematology products from Diatron MI PLC, which are primarily denominated in Euros. To the extent the U.S. dollar strengthens against the Euro currency, the translation of the foreign currency denominated transactions may result in reduced cost of revenues and operating expenses. Similarly, our cost of revenues and operating expenses will increase if the U.S. dollar weakens against the Euro currency.

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Investment in a Privately Held Company

In February 2011, we purchased a 15% equity ownership interest in SMB, for $2.8 million in cash. SMB is a privately-held developer and manufacturer of point-of-care diagnostic products for veterinary use. SMB, based in Farum, Denmark, has been the original equipment manufacturer of the Abaxis VetScan VSpro point-of-care specialty analyzer since 2008. The investment is recorded in "Investment in Unconsolidated Affiliate" in our condensed consolidated balance sheets and we use the equity method to account for our investment in this entity because we do not control it, but have the ability to exercise significant influence over it. As of September 30, 2014, the total carrying amount of our investment in SMB was $2.6 million. The investment is inherently risky and we could lose our entire investment in this company. To date, since our investment in SMB, we have not recorded an impairment charge on this investment.

Other than the foregoing, there have been no material changes in our market risk during the three months ended September 30, 2014 compared to the disclosures in Part II, Item 7A of our Annual Report on Form 10-K for the fiscal year ended March 31, 2014.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"), as of September 30, 2014. Based on such evaluation, our principal executive officer and principal financial officer have concluded that, as of such date, our disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the fiscal quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting, as defined in Rule 13a 15(f) and 15d 15(f) under the Exchange Act.

Inherent Limitations on Controls and Procedures

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

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

On October 1, 2012, St. Louis Police Retirement System, a purported shareholder of Abaxis, filed a lawsuit against certain officers and each of the directors of the Company in the United States District Court for the Northern District of California alleging, among other things, that the directors violated Section 14(a) of the Securities Exchange Act of 1934 and breached their fiduciary duties by allegedly failing to disclose material information in our 2010 proxy statement, breached their fiduciary duties by allegedly violating the terms of our 2005 Equity Incentive Plan, and breached their fiduciary duties by failing to disclose alleged material information in our 2012 proxy statement regarding (1) the events leading up to our proposal to amend the 2005 Equity Incentive Plan to eliminate the limit on the number of shares that may be issued pursuant to restricted stock units, and (2) the effects of the proposed amendment on certain settled and outstanding restricted stock units. The plaintiff seeks, among other things, damages, disgorgement and attorney's fees. In addition, the plaintiff sought, and on October 23, 2012, the court issued, an order preliminarily enjoining our shareholder vote on Proposal 2 in our 2012 proxy statement, regarding an amendment to the 2005 Equity Incentive Plan, until such time as additional disclosures could be made. We filed with the SEC and mailed to shareholders supplemental proxy materials approved by the court, the injunction was lifted and our shareholders approved the proposal to amend our 2005 Equity Incentive Plan. A hearing on defendants' motion to dismiss the claims was held on May 7, 2013.

On October 1, 2013, before the court ruled on the motions to dismiss, the parties notified the court that they had reached a settlement of the lawsuit. On January 16, 2014, the parties entered into a Stipulation of Settlement, and the following day, the plaintiff filed a motion for preliminary approval. On April 15, 2014, the court issued an order granting preliminary approval of the settlement. A hearing on the motion for final approval of the settlement and the plaintiff's petition for attorney's fees was held on June 17, 2014. On August 12, 2014, the Court issued a final judgment order, among other things, approving the settlement. Pursuant to the settlement, the parties have agreed that the claims against the defendants will be dismissed with prejudice and will be granted the release of certain known or unknown claims that have been or could have been brought later in the court arising out of the same allegations. We have also agreed that we will adopt certain corporate governance measures, such measures to be in effect for at least five years. The court also awarded $579,430 in attorney's fees and costs to plaintiff's counsel, which was paid by the Company's insurance. We believe that the attorney's fees that were awarded to the plaintiff's counsel did not have a material adverse effect on Abaxis, our consolidated financial position or our results of operations.

We are involved from time to time in various litigation matters in the normal course of business. There can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows.

Item 1A. Risk Factors

RISK FACTORS THAT MAY AFFECT OUR PERFORMANCE

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

When used in these risk factors, the words "anticipates," "believes," "continue," "could," "estimates," "expects," "future," "int "may," "might," "plans," "projects," "will" and similar expressions identify forward-looking statements. Our actual results cou differ materially from those that we project in the forward-looking statements as a result of factors that we have set forth throughout this document as well as additional risks not presently known to us or that we currently believe are immaterial that may also significantly impair our business operations.

In evaluating our business, you should carefully consider the following risks in addition to the other information in our Annual Report on Form 10-K for the fiscal year ended March 31, 2014 as filed with the Securities and Exchange Commission on May 30, 2014. We note these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. It is not possible to predict or identify all such factors and, therefore, you should not consider the following risks to be a complete statement of all the potential risks or uncertainties that we face.

Our facilities and manufacturing operations are vulnerable to interruption as a result of natural disasters, system failures and other business disruptions. Any such interruption may harm our business.

Our business depends on the efficient and uninterrupted operation of our manufacturing operations, which are co-located with our corporate headquarters in Union City, California. These manufacturing operations are vulnerable to damage or interruption from earthquakes, fire, floods, power loss, telecommunications failures, break-ins and similar events. A failure of manufacturing operations, be it in the development and manufacturing of our Piccolo or VetScan blood chemistry analyzers or the reagent discs used in the blood chemistry analyzers, could result in our inability to supply customer demand. We do not have a backup facility to provide redundant manufacturing capacity in the event of a system failure or other significant loss or problem. Accordingly, if our manufacturing operations in Union City, California were interrupted, we may be required to bring an alternative facility online, a process that could take several weeks to several months or more. The occurrence of a business disruption could harm our revenue and financial condition and increase our costs and expenses.

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We operate and manage our business by relying on several information systems to maintain financial records, process customer orders, manage inventory, process shipments to customers and operate other critical functions. Information technology system failures, network disruptions and breaches of data security could disrupt our operations. If we were to experience a system disruption in the information technology systems that enable us to interact with customers and suppliers, it could result in the loss of sales and customers, delays or cancellation of orders, impeding the manufacture or shipment of products, processing transactions and reporting financial results and significant incremental costs. While management has taken steps to address these concerns by implementing network security and internal control measures, there can be no assurance that a system failure or data security breach will not have a material adverse effect on our business, financial condition and operating results.

Although we carry property and business interruption insurance to insure against the financial impact of certain events of this nature, our coverage may not be adequate to compensate us for all losses that may occur.

We are not able to predict sales in future quarters and a number of factors affect our periodic results, which may result in significant variance in our quarterly operating results and may negatively impact our stock price.

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

We generally operate with a limited order backlog, because we ship our products shortly after we receive the orders from our customers. As a result, our product sales in any quarter are generally dependent on orders that we receive and ship in that quarter. Any such revenues shortfall would immediately materially and adversely impact our operating results and financial condition.

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

·new product or service announcements made by us or our competitors;

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

·the sales performance of our independent distributors;

·excess inventory levels and inventory imbalances at our independent distributors;

·our ability to develop, introduce and market new products or services on a timely basis, or at all;

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

·the mix of sales among our instruments, consumable products and services;

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the amount of our research and development and sales, general and administrative expenses; and

·changes in our strategies.

As a result, it is likely that in some periods our operating results will not meet investor expectations or those of public market analysts. Any unanticipated change in revenues or operating results is likely to cause our stock price to fluctuate since such changes reflect new information available to investors and analysts. Any fluctuations in our quarterly results may not accurately reflect the underlying performance of our business and could cause a decline in the trading price of our common stock.

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In the United States, we rely on Abbott as our exclusive distributor in certain medical market to sell our products. Our dependency on Abbott means that any failure to successfully develop products and maintain this relationship could adversely affect our business.

Abbott has the exclusive right to sell and distribute our Piccolo Xpress chemistry analyzer and associated consumables in the United States professionally-attended human healthcare market, excluding sales and distribution to Catapult Health LLC and specified customer segments, which includes pharmacy and retail store clinics, shopping malls, clinical research organizations and cruise ship lines. As a result of the Abbott Agreement, we no longer have control over the marketing and sale of our primary medical products into most of the U.S. medical market and are dependent upon the efforts and priorities of Abbott in promoting and creating a demand for such products in such market. Should these efforts be unsuccessful, our business, financial condition and results of operations are likely to be adversely affected. Specifically, we do not have any control over pricing, inventory levels, distribution efforts and other factors that may impact the level of sales achieved, timing of revenue recognized and other adjustments that may impact our reported sales. Moreover, we are dependent upon Abbott's forecasts and sales efforts and maintenance of pre-existing sub-distributor agreements that were assigned to Abbott. The transition of this U.S. medical business has had an adverse effect on our revenues during fiscal 2014, with respect to lower average selling prices of Piccolo products sold to Abbott and the timing of purchases of our products now sold by Abbott as it integrated our products into its sales process.

In addition, as a result of the Abbott Agreement, we have substantially reduced the size of our United States medical sales force. The initial term of the Abbott Agreement ends on December 31, 2017, and after the initial term, the agreement renews automatically for successive one-year periods unless terminated by either party based upon a notice of non-renewal six months prior to the then-current expiration date. In the event the agreement is terminated, we would be required to invest and re-establish presence and sales capabilities in markets that were served by Abbott and/or identify one or more suitable replacement distribution partner(s), which would require significant time and effort. We could not be assured of replacing the capabilities of Abbott in those markets. New sales personnel and distribution partners take time to train and gain full productivity with customers, and if we are unable to accomplish this successfully, our business, financial condition and results of operations could be adversely affected. Should we fail to effectively develop our sales, marketing and distribution efforts and navigate regulatory challenges, our growth will be limited and our results of operations will be adversely affected.

A failure to manage the inventory levels of our distributors effectively may adversely affect our gross margins and results of operations.

We must manage the inventory of our products held by our distributors effectively. Any excess or shortage of inventory held by our distributors could affect our results of operations. Our distributors may increase orders during periods of product shortages and cancel or delay orders if their inventory is too high. They also may adjust their orders in response to the supply of our products, the products of our competitors that are available to them, and in response to seasonal fluctuations in customer demand. Revenues from sales to our distributors generally are recognized based upon shipment of our products to the distributors, net of estimated sales allowances, discounts and rebates. Inventory management remains an area of focus as we balance inventory levels of our instruments and consumables, especially in our United States veterinary market distribution channel, consisting of both national and regional distributors. We must also balance the need to maintain sufficient inventory levels in the distribution channel against the risk of inventory obsolescence because of the shelf life of our consumable products and customer demand. If we ultimately determine that we have excess inventory at our distributors or inventory imbalances in the distribution channel, we may have to reduce our selling prices, which could result in lower gross margins. During the second half of fiscal 2014, as compared to the same period in fiscal 2013, our revenues were adversely impacted in the United States veterinary market by excess channel inventory and inventory imbalances and resulted to a decrease of sales orders from our largest distributors in the veterinary market. The excess channel inventory was the result of our distributors not selling our products to end customers at the same rate as they were purchasing products from us.

Should our efforts to monitor and manage channel inventory be unsuccessful, our business, financial condition and results of operations are likely to be adversely affected.

We would fail to achieve anticipated revenues if the market does not accept our products or services.

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

In the human medical market, we believe that our blood chemistry analyzers offer customers many advantages, including substantial improvements in practice efficiencies. However, the implementation of point-of-care diagnostics in physicians' offices involves changes to current standard practices, such as using large clinical laboratories, and adopting our technology requires a shift in both the procedures and mindset of care providers. The human medical market in particular is highly regulated, structured, difficult to penetrate and often slow to adopt new product offerings. If we or our distribution partner, Abbott, are unable to convince large numbers of medical clinics, hospitals and other point-of-care environments of the benefits of our Piccolo blood chemistry analyzers and our other products, we could fail to achieve anticipated revenue.

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Historically, in the veterinary market, we have marketed our VetScan products through both direct sales and distribution channels to veterinarians. We continue to develop new animal blood tests to expand our product offerings; however, we cannot be assured that these products will be accepted by the veterinary market. Any failure to achieve market acceptance with our current or future products or services would harm our business and financial condition.

We depend on limited or sole suppliers, many of whom we do not have long-term contracts with, and failure of our suppliers to provide the components or products to us could harm our business.

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

- Blood Chemistry Analyzer Components: Our blood analyzer products use several technologically-advanced components that we currently purchase from a limited number of suppliers, including certain components from our single source supplier, Hamamatsu Corporation. Our analyzers also use a printer that is primarily made by Seiko North America Corporation. The loss of the supply of any of these components could force us to redesign our blood chemistry analyzers.

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

- Reagent Chemicals: We currently depend on the following single source vendors for some of the chemicals that we use to produce the reagents and dry reagent chemistry beads that are either inserted in our reagent discs, lateral flow rapid tests or sold as stand-alone products: Amano Enzyme USA Co., Ltd., Kikkoman Corporation Biochemical Division, Microgenics Corporation, a division of Thermo Fisher Scientific, Roche Molecular Biochemicals of Roche Diagnostics Corporation, a division of F. Hoffmann-La Roche, Ltd., SA Scientific Co., Sekisui Diagnostics, Sigma Aldrich Inc. and Toyobo Specialties.

We market original equipment manufacturer supplied products that are currently available from limited sources as discussed below.

- Hematology Instruments and Reagent Kits: Our VetScan hematology instruments are manufactured by Diatron in Hungary and are purchased by us as a completed instrument. In addition, we currently have qualified two suppliers to produce the reagent kits for our hematology instruments: Clinical Diagnostic Solutions, Inc. and Diatron.

- VSpro Specialty Analyzers and Cartridges: Our VetScan VSpro specialty analyzers and cartridges are manufactured by SMB in Denmark and are purchased by us as completed products.

- i-STAT Analyzers and Cartridges: Our VetScan i-STAT 1 analyzers and cartridges are manufactured by Abbott and are purchased by us as completed products.

- Rapid Tests: Substantially all of our VetScan Rapid Tests are manufactured by a single source supplier.

We currently have purchase obligations with SMB to purchase VSpro specialty analyzers and related cartridges and Diatron to purchase Diatron hematology instruments. However, with our other suppliers, we primarily operate on a purchase order basis and, therefore, these suppliers are under no contractual obligation to supply us with their products or to do so at specified prices. Although we believe that there may be potential alternate suppliers available for these critical components, to date we have not qualified additional vendors beyond those referenced above and cannot assure you we would be able to enter into arrangements with additional vendors on favorable terms, or at all. For the

suppliers of original equipment manufactured products that we have long-term contracts with, there can be no assurance that these suppliers will always fulfill their obligations under these contracts, or that any suppliers will not experience disruptions in their ability to supply our requirements for products. In addition, under some contracts with suppliers we have minimum purchase obligations and our failure to satisfy those obligations may result in loss of some or all of our rights under these contracts.

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

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We rely primarily on distributors to sell our products and we rely on sole distributor arrangements in a number of countries. Our failure to successfully develop and maintain these relationships could adversely affect our business.

We sell our medical and veterinary products primarily through a limited number of distributors. As a result, we are dependent upon these distributors to sell our products and to assist us in promoting and creating a demand for our products. We operate on a purchase order basis with the distributors and the distributors are under no contractual obligation to continue carrying our products. Further, many of our distributors may carry our competitors' products, and may promote our competitors' products over our own products.

We depend on a number of distributors in North America who distribute our VetScan products. In the United States veterinary market segment, we rely on MWI, a national distributor, and on various independent regional distributors. We depend on our distributors to assist us in promoting our products in the veterinary market, and accordingly, if one or more of our distributors were to stop selling our products in the future, we may experience a temporary sharp decline or delay in our sales revenues until our customers identify another distributor or purchase products directly from us.

Internationally, we rely on only a few distributors for our products in both the medical and veterinary diagnostic markets. We currently rely on distributors that carry either our medical or veterinary products in the following countries: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, France, Germany, Hong Kong, India, Indonesia, Ireland, Israel, Italy, Japan, Korea, Macao, Mexico, the Netherlands, New Zealand, the Philippines, Poland, Portugal, Romania, Russia, Singapore, Spain, Sweden, Switzerland, Turkey, the United Arab Emirates, the United Kingdom and the United States. Our distributors in each of these countries are responsible for obtaining the necessary approvals to sell our new and existing products. These distributors may not be successful in obtaining proper approvals for our new and existing products in their respective countries, and they may not be successful in marketing our products. Furthermore, an inability of, or any delays by, our distributor in receiving the necessary approvals for our new or other products can adversely impact our revenues in a country. We plan to continue to enter into additional distributor relationships to expand our international distribution base and presence. However, we may not be successful in entering into additional distributor relationships on favorable terms, or at all. In addition, our distributors may terminate their relationship with us at any time. Historically, we have experienced a high degree of turnover among our international distributors. This turnover makes it difficult for us to establish a steady distribution network overseas. Consequently, we may not be successful in marketing our Piccolo and VetScan products internationally, and our business and financial condition may be harmed as a result.

We must increase sales of our Piccolo and VetScan products or we may not be able to increase or sustain profitability.

Our ability to continue to be profitable and to increase profitability will depend, in part, on our ability to increase our sales volumes of our Piccolo and VetScan products. Increasing the sales volume of our products will depend upon, among other things:

·the sales performance of our independent distributors;

·our ability to improve our existing products and develop new and innovative products;

·our ability to increase our sales and marketing activities;

·our ability to effectively manage our manufacturing activities; and

·our ability to effectively compete against current and future competitors.

We cannot assure you that we will be able to successfully increase the sales volumes of our products to increase or sustain profitability.

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

The human diagnostic market is fragmented, heavily regulated and constantly changing. Our limited sales, marketing and distribution capabilities are continually challenged to translate these changes into compelling value propositions for our prospective customers. Accordingly, we cannot assure you that:

· we will be able to maintain consistent growth through our independent distributors;

· the costs associated with sales, marketing and distributing our products will not be excessive; or

· government regulations or private insurer policies will not adversely affect our ability to be successful.

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

Our future success depends, to a great degree, on the principal members of our management and scientific staff. The loss of any of these key personnel, including in particular Clinton H. Severson, our President, Chief Executive Officer and Chairman of our Board of Directors, might impede the achievement of our business objectives. We may not be able to continue to attract and retain skilled and experienced marketing, sales and manufacturing personnel on acceptable terms in the future because numerous medical products and other high technology companies compete for the services of these qualified individuals. If we are unable to hire and train qualified personnel, we may not be able to maintain or expand our business. Additionally, if we are unable to retain key personnel, we may not be able to replace them readily or on terms that are reasonable, which also could hurt our business. We currently do not maintain key man life insurance on any of our employees.

The failure of our Abaxis Veterinary Reference Laboratories to compete effectively and achieve profitability could have a negative impact on our growth and profitability.

For AVRL to compete effectively and achieve profitability, we must convince our existing and prospective customers in the veterinary market that our service offerings would be an attractive revenue-generating addition to their practices. In addition, we have to demonstrate that the services offered now and in the future at AVRL are and will be attractive alternatives to those offered by our competitors, by differentiating our services on the basis of such factors as the range of tests offered, turnaround time, cost effectiveness and reliability of results. This is difficult to do, especially to compete with existing competitors and new market entrants. Some of our competitors for sales of on-site testing products have a more established relationship with these customers than we do, which could inhibit AVRL's market penetration efforts. We cannot be assured that AVRL or its services will be accepted by the veterinary market. If we are unable to convince large numbers of veterinarians of the benefits of AVRL or otherwise fail to achieve market acceptance for AVRL's services, the growth of AVRL will be limited accordingly, which could harm our laboratory business and financial condition.

We may experience manufacturing problems related to our instruments, which could materially and adversely affect our revenues and business.

We manufacture our blood chemistry analyzers at our manufacturing facility in Union City, California. Should we experience problems related to the manufacture of our blood chemistry analyzer, we could fail to achieve anticipated revenues or we may incur an additional increase in our cost of revenues. These problems may include manufacturing defects and product failures, defects in raw materials acquired from our suppliers, delays in receipt of raw materials from our suppliers, obsolescence, increases in raw materials costs and labor disturbances. There can be no assurance that our efforts to resolve manufacturing difficulties will be successful or that similar problems will not arise in the future. If we are unable to prevent such problems from occurring in the future, we may not be able to manufacture sufficient quantities to meet anticipated demand and, therefore, will not be able to effectively market and sell our blood chemistry analyzers or other instruments that we market and sell; accordingly, our revenues and business would be materially adversely affected.

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

We have developed a blood analysis system that consists of a portable blood analyzer and single-use reagent discs. Each reagent disc performs a series of standard blood tests. We believe that it is necessary to develop additional series of reagent discs with various tests for use with the Piccolo chemistry analyzers if we are to compete in that market. Historically, we have developed reagent discs suitable for the human medical and veterinary diagnostic markets. We have received 510(k) clearances from the U.S. Food and Drug Administration ("FDA") for 27 test methods in the human

medical market. These tests are included in standard tests for which the medical community receives reimbursements from third-party payors such as managed care organizations and Medicare. We may not be able to successfully manufacture or market these reagent discs. Our failure to meet these challenges will materially adversely affect our operating results and financial condition.

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

As of September 30, 2014, 71 patent applications have been filed on our behalf with the United States Patent and Trademark Office ("USPTO"), of which 40 patents have been issued and 13 patents are currently active. Additionally, we have filed several international patent applications covering the same subject matter as our domestic applications. The patent position of any medical device manufacturer, including us, is uncertain and may involve complex legal and factual issues. Consequently, we may not be issued any additional patents, either domestically or internationally. Furthermore, our patents may not provide significant proprietary protection because there is a chance that they will be circumvented or invalidated. We cannot be certain that we were the first creator of the inventions covered by our issued patents or pending patent applications, or that we were the first to file patent applications for these inventions, because (1) the USPTO maintains all patent applications that are not filed in any foreign jurisdictions in secrecy until it issues the patents (when a patent application owner files a request for nonpublication) and (2) publications of discoveries in the scientific or patent literature tend to lag behind actual discoveries by several months. We may have to participate in interference proceedings, which are proceedings in front of the USPTO, to determine who will be issued a patent. These proceedings could be costly and could be decided against us.

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

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

The diagnostic market is a well-established field in which there are a number of competitors that have substantially greater financial and operational resources and larger, more established marketing, sales and service organizations than we do. We compete primarily with the following organizations: commercial clinical laboratories, hospitals' clinical laboratories, and manufacturers of bench top multi-test blood analyzers and other testing systems that health care providers can use "on-site" (a listing of our competitors is listed below).

Historically, hospitals and commercial laboratories perform most of the human diagnostic testing, and veterinary specialized commercial laboratories perform most of the veterinary medical testing. We have identified five principal factors that we believe customers typically use to evaluate our products and those of our competitors. These factors include the following: range of tests offered, immediacy of results, cost effectiveness, ease of use, and reliability of results. We believe that we compete effectively on each of these factors except for the range of tests offered. Clinical laboratories are effective at processing large panels of tests using skilled technicians and complex equipment. Currently, while our offering of instruments and reagent discs does not provide the same broad range of tests as hospitals and commercial laboratories, we believe that in certain markets, our products provide a sufficient breadth of test menus to compete successfully with clinical laboratories given the advantages of our products with respect to the other four factors. In addition, we cannot assure you that we will continue to be able to compete effectively on cost effectiveness, ease of use, immediacy of results or reliability of results. We also cannot assure you that we will ever be able to compete effectively on the basis of range of tests offered.

Our principal competitors in the point-of-care human medical diagnostic market are Alere, Alfa Wassermann S.P.A., Johnson & Johnson (including its subsidiary, Ortho-Clinical Diagnostics, Inc.) and F. Hoffmann-La Roche Ltd. Additionally, in certain segments of the human medical diagnostic market, we compete with Abbott's i-STAT division. Many of our competitors in the human medical diagnostic market have significantly larger product lines to offer and greater financial and other resources than we do. In particular, many of these competitors have large sales forces and well-established distribution channels and brand names.

Our principal competitors in the veterinary diagnostic market are Idexx Laboratories, Inc. and Heska Corporation. Idexx has a larger veterinary product line and sales force than we do and a large sales infrastructure network and brand name. Consequently, we must develop our distribution channels and significantly expand our direct sales force in order to compete more effectively in these markets. Our veterinary reference laboratory, AVRL, competes in the commercial laboratory arena nationwide with a full menu of laboratory diagnostics. We differentiate our services on the following factors: range of tests offered, turnaround time, cost effectiveness and reliability of results. AVRL's principal competitors are Idexx Laboratories, Inc and Antech Diagnostics, a division of VCA Antech, Inc.

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

By regulating the maximum amount of reimbursement they will provide for blood testing services, third-party payors, such as managed care organizations, pay-per-service insurance plans, and the Centers for Medicare and Medicaid

Services (the “CMS”), can indirectly affect the pricing or the relative attractiveness of our human testing products. For example, the CMS set the level of reimbursement of fees for blood testing services for Medicare beneficiaries. If third-party payors decrease the reimbursement amounts for blood testing services, it may decrease the likelihood that physicians and hospitals will adopt point-of-care diagnostics as a viable means of care delivery. Consequently, we would need to charge less for our products. If the government and third-party payors do not provide for adequate coverage and reimbursement levels to allow health care providers to use our products, the demand for our products will decrease and our business and financial condition would be harmed.

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The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act, collectively, PPACA, enacted in March 2010, made changes that are expected to significantly impact the medical device industries and clinical laboratories. Beginning in January 2013, each medical device manufacturer has to pay an excise tax in an amount equal to 2.3% of the price for which such manufacturer sells its medical devices. The PPACA also mandates a reduction in payments for clinical laboratory services paid under the Medicare Clinical Laboratory Fee Schedule, or CLFS, of 1.75% for the calendar years 2011 through 2015 and a productivity adjustment to the CLFS, further reducing payment rates. Some commercial payors are guided by the CLFS in establishing their reimbursement rates. Clinicians may decide not to order clinical diagnostic tests if third party payments are inadequate, and we cannot predict whether third-party payors will offer adequate reimbursement for tests utilizing our products to make them commercially attractive. Changes in healthcare policy, such as the creation of test utilization limits for diagnostic products in general or requirements that Medicare patients pay for portions of clinical laboratory tests or services received, could substantially impact the sales of our tests, increase costs and divert management's attention from our business. In addition, sales of our tests outside of the United States will subject us to foreign regulatory requirements, which may also change over time.

We may be subject, directly or indirectly, to federal and state healthcare fraud and abuse laws and other federal and state laws applicable to our marketing practices. If we are unable to comply, or have not complied, with such laws, we could face substantial penalties.

Our operations are directly, or indirectly through our customers, subject to various federal and state fraud and abuse laws, including, without limitation, the federal and state anti-kickback statutes, physician payment transparency laws and false claims laws. These laws may impact, among other things, our sales and marketing and education programs and require us to implement additional internal systems for tracking certain marketing expenditures and reporting them to government authorities. In addition, we may be subject to patient privacy regulation by both the federal government and the states in which we conduct our business. If our operations are found to be in violation of any of these laws or any other governmental regulations that apply to us, we may be subject to penalties, including civil and criminal penalties, damages, fines and the curtailment or restructuring of our operations, the exclusion from participation in federal and state healthcare programs and imprisonment, any of which could adversely affect our ability to operate our business and our results of operations.

Approval and/or clearance by the FDA, USDA and foreign regulatory authorities for our products requires significant time and expenditures.

Before we may commercialize our human medical diagnostic products in the United States, we are required to obtain either 510(k) clearance or pre-marketing approval ("PMA") from the FDA, unless an exemption from pre-market review applies. In our veterinary market, certain products that we sell are subject to regulations pertaining to veterinary biologics, for which we must obtain approval from the USDA's Center for Veterinary Biologics. The process of obtaining regulatory clearances or approvals to market a medical device can be costly and time consuming, and we may not be able to successfully obtain 510(k) clearance from the FDA or may be subject to the more costly and time-consuming PMA process.

In addition, governmental agencies may change their clearance or approval policies, adopt additional regulations or revise existing regulations, or take other actions which may prevent or delay approval or clearance of our products under development or impact our ability to modify our currently approved or cleared products on a timely basis. Any delay in, or failure to receive or maintain, clearance or approval for our products could prevent us from generating revenue from these products and adversely affect our business operations and financial results.

The FDA and other regulatory authorities have broad enforcement powers. For example, the manufacture of medical devices must comply with the FDA's Quality System Regulation ("QSR"). In addition, manufacturers must register their manufacturing facilities, list the products with the FDA, and comply with requirements relating to labeling, marketing,

complaint handling, adverse event and medical device reporting, reporting of corrections and removals, and import and export. The FDA monitors compliance with the QSR and these other requirements through periodic inspections. If our facilities or those of our manufacturers or suppliers are found to be in violation of applicable laws and regulations, or if we or our manufacturers or suppliers fail to take satisfactory corrective action in response to an adverse inspection, the regulatory authority could take enforcement actions that could impair our ability to produce our products in a cost-effective and timely manner in order to meet our customers' demands, and could have a material adverse effect on our reputation, business, results of operations and financial condition. We may also be required to bear other costs or take other actions that may have a negative impact on our future sales and our ability to generate profits.

Sales of our products outside the United States are subject to foreign regulatory requirements governing vigilance reporting, marketing approval, manufacturing, product licensing, pricing and reimbursement. These regulatory requirements vary greatly from country to country. As a result, the time required to obtain approvals outside the United States may differ from that required to obtain FDA clearance or USDA approval, and we may not be able to obtain foreign regulatory approvals on a timely basis or at all. Clearance or approval by the FDA does not ensure approval by regulatory authorities in other countries, and approval by one foreign regulatory authority does not ensure clearance or approval by regulatory authorities in other countries or by the FDA.

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A recall of our products, or the discovery of serious safety issues with our products that leads to corrective actions, could have a significant adverse impact on us.

The FDA, USDA and similar foreign governmental authorities have the authority to require the recall of commercialized products in the event of material deficiencies or defects in design or manufacture of a product or in the event that a product poses an unacceptable risk to health. Manufacturers may, under their own initiative, recall a product if any material deficiency in a device is found. A government-mandated or voluntary recall by us or one of our distributors could occur as a result of component failures, manufacturing errors, design or labeling defects or other deficiencies and issues. We are required to report to the FDA any incident in which our product may have caused or contributed to a death or serious injury or in which our product malfunctioned and, if the malfunction were to recur, would likely cause or contribute to death or serious injury. Repeated product malfunctions may result in a voluntary or involuntary product recall. Recalls of any of our products would divert managerial and financial resources and have an adverse effect on our reputation, results of operations and financial condition, which could impair our ability to produce our products in a cost-effective and timely manner in order to meet our customers' demands. Moreover, if we do not adequately address problems associated with our devices, we may face additional regulatory enforcement action, including FDA warning letters, product seizure, injunctions, administrative penalties, or civil or criminal fines. We may also be required to bear other costs or take other actions that may have a negative impact on our sales as well as face significant adverse publicity or regulatory consequences, which could harm our business, including our ability to market our products in the future.

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

Our business exposes us to potential warranty and product liability risks that are inherent in the design, testing, manufacturing and marketing of human and veterinary medical products. Although we have established procedures for quality control on both the raw materials that we receive from suppliers as well as the design and manufacturing of our products, these procedures may prove inadequate to detect a design or manufacturing defect. In addition, our Piccolo and VetScan chemistry analyzers may be unable to detect all errors that could result in the misdiagnosis of human or veterinary patients.

We may be subject to substantial claims for defective products under our warranty policy or product liability laws. In addition, our policy is to credit medical providers for any defective product that we produce, including those reagent discs that are rejected by our Piccolo and VetScan chemistry analyzers. Therefore, even if a mass defect within a lot or lots of reagent discs were detected by our Piccolo and VetScan chemistry analyzers, the replacement of such reagent discs free of charge would be costly and could materially harm our financial condition. Further, in the event that a product defect is not detected in our Piccolo chemistry analyzer, our expansion into the human medical market greatly increases the risk that the amount of damages involved with just one product defect would be material to our operations. Our product liability insurance and cash may be insufficient to cover potential liabilities. In addition, in the future the coverage that we require may be unavailable on commercially reasonable terms, if at all. Even with our current insurance coverage, a mass product defect, product liability claim or recall could subject us to claims above the amount of our coverage and would materially adversely affect our business and our financial condition.

We may be subject to litigation for a variety of claims, which could adversely affect our results of operations, harm our reputation or otherwise negatively impact our business.

In addition to product liability claims, we and our directors and officers may be subject to claims arising from our normal business activities. These may include claims, suits, and proceedings involving shareholder and fiduciary matters, intellectual property, labor and employment, wage and hour, commercial and other matters, such as the suit filed by the St. Louis Police Retirement System litigation described under "Legal Proceedings" in Part II, Item 1 of this report. The outcome of any litigation, regardless of its merits, is inherently uncertain. Any claims and lawsuits, and

the disposition of such claims and lawsuits, could be time-consuming and expensive to resolve, divert management attention and resources, and lead to attempts on the part of other parties to pursue similar claims. Any adverse determination related to litigation could adversely affect our results of operations, harm our reputation or otherwise negatively impact our business. In addition, depending on the nature and timing of any such dispute, a resolution of a legal matter could materially affect our future results of operations, our cash flows or both.

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

The market price of our common stock, like the securities of many other medical products companies, fluctuates over a wide range, and will continue to be highly volatile in the future. During the quarter ended September 30, 2014, the closing sale prices of our common stock on the NASDAQ Global Select Market ranged from $41.80 to $53.11 per share and the closing sale price on September 30, 2014, was $50.71 per share. During the last eight fiscal quarters ended September 30, 2014, our stock price closed at a high of $53.11 per share on September 18, 2014 and a low of $32.40 per share on October 23, 2013. Many factors may affect the market price of our common stock, including:

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- fluctuation in our operating results;

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

- changes in governmental regulation in the United States and internationally;

- prospects and proposals for health care reform;

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

- developments or disputes concerning our patents or our other proprietary rights;

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

- general market conditions.

In the past, stockholders have filed securities class action litigation following periods of market volatility. If we were to become involved in such securities litigation, it could subject us to substantial costs, divert resources and the attention of management from our business, and adversely affect our business. Because our stock price is so volatile, investing in our common stock is highly risky. A potential investor must be able to withstand the loss of his entire investment in our common stock.

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

For our international sales denominated in U.S. dollars, an increase in the value of the U.S. dollar relative to foreign currencies could make our products less competitive in international markets. For our sales denominated in foreign currencies, we are subject to fluctuations in exchange rates between the U.S. dollar and the particular foreign currency and changes in such exchange rates could materially impact our reported results of operations and distort period to period comparisons. Our operating results could also be adversely affected by the seasonality of international sales and the economic conditions of our overseas markets.

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

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

We cannot predict the outcome of our testing in future periods. In the event that our internal control over financial reporting is not effective as defined under Section 404, or any failure to implement required new or improved controls, or difficulties encountered in implementation could harm operating results or prevent us from accurately reporting financial results or cause a failure to meet our reporting obligations in the future. If management cannot assess internal control over financial reporting is effective, or our independent registered public accounting firm is unable to provide an unqualified attestation report on such assessment, investor confidence and our share value may be negatively impacted.

Regulations related to conflict minerals could adversely impact our business.

The Dodd-Frank Wall Street Reform and Consumer Protection Act contains provisions to improve transparency and accountability concerning the supply of tin, tantalum, tungsten and gold, known as conflict minerals, originating from the Democratic Republic of Congo, or the DRC, and adjoining countries. As a result, in August 2012 the SEC adopted annual disclosure and reporting requirements for public companies that use conflict minerals mined from the DRC and adjoining countries in their products. We have determined that we use at least one of these conflict minerals in the manufacture of our products, although we have not yet determined the source of the conflict minerals that we use. These new disclosure requirements require us to use diligent efforts to determine which conflict minerals we use and the source of those conflict minerals, and disclose the results of our findings beginning in May 2014. There are and will be costs associated with complying with these disclosure requirements, including those costs incurred in conducting diligent efforts to determine which conflict minerals we use and the sources of conflict minerals used in our products. Further, the implementation of these rules could adversely affect the sourcing, supply and pricing of materials used in our products. As there may be only a limited number of suppliers offering conflict free conflict minerals, we cannot be sure that we will be able to obtain necessary conflict free conflict minerals in sufficient quantities or at competitive prices. In addition, we may face reputational challenges if we determine that our products contain minerals not determined to be conflict free or if we are unable to sufficiently verify the origins for all conflict minerals used in our products through the procedures we may implement. If we determine to redesign our products to not use conflict minerals, we would incur additional costs.

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

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

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

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

Our ability to issue preferred stock may delay or prevent a change of control of Abaxis.

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

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

None.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

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Item 6. Exhibits

Exhibit No.	Description of Document
3.1	Amended and Restated Articles of Incorporation, as amended (filed with the Securities and Exchange Commission on May 30, 2014 as Exhibit 3.1 to our Annual Report on Form 10-K for the fiscal year ended March 31, 2014 (SEC File No. 000-19720) and incorporated herein by reference).
3.2	By-laws, as amended (filed with the Securities and Exchange Commission on May 30, 2014 as Exhibit 3.2 to our Annual Report on Form 10-K for the fiscal year ended March 31, 2014 (SEC File No. 000-19720) and incorporated herein by reference).
10.1*	Transition/Separation Agreement between Abaxis, Inc. and Vladimir E. Ostoich, Ph.D., dated August 15, 2014 (filed with the Securities and Exchange Commission on August 21, 2014 as Exhibit 10.1 to our Current Report on Form 8-K (SEC File No. 000-19720) and incorporated herein by reference).
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1#	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2#	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Management contract or compensatory plan or arrangement.

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

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SIGNATURES

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

ABAXIS, INC.
(Registrant)

Date: November 10, 2014 BY: /s/ Clinton H. Severson
Clinton H. Severson
President, Chief Executive Officer and Director
(Principal Executive Officer)

Date: November 10, 2014 BY: /s/ Alberto R. Santa Ines
Alberto R. Santa Ines
Chief Financial Officer and Vice President of Finance
(Principal Financial and Accounting Officer)

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