SOMANETICS CORP
Form 10-Q
October 06, 2006

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended AUGUST 31, 2006

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to __________

Commission file number 0-19095

SOMANETICS CORPORATION
(Exact name of registrant as specified in its charter)

MICHIGAN	38-2394784
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1653 EAST MAPLE ROAD
TROY, MICHIGAN
48083-4208
(Address of principal executive offices)
(Zip Code)

(248) 689-3050
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

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

Yes [X] No [ ]

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

Large accelerated filer [ ]   Accelerated filer [X]   Non-accelerated filer [ ]

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

Yes [ ] No [X]

Number of common shares outstanding at October 6, 2006: 13,156,027

PART I FINANCIAL INFORMATION

SOMANETICS CORPORATION

BALANCE SHEETS

	AUGUST 31, 2006 (Unaudited)	NOVEMBER 30 2005 (Audited)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 21,386,085	$ 13,148,23
Marketable securities	22,059,577	-
Accounts receivable	5,147,384	3,531,74
Inventory	2,029,797	1,058,10
Prepaid expenses	147,691	623,30
Deferred tax asset - current	1,979,582	1,561,32
Total current assets	52,750,116	19,922,70
PROPERTY AND EQUIPMENT (at cost):		
Demonstration and no capital cost sales equipment at customers	2,395,886	1,916,65
Machinery and equipment	1,244,282	768,99
Furniture and fixtures	297,257	289,39
Leasehold improvements	195,565	187,13
Total	4,132,990	3,162,17
Less accumulated depreciation and amortization	(2,161,964)	(1,836,43
Net property and equipment	1,971,026	1,325,74
OTHER ASSETS:		
Long-term investments	26,139,122	-
Deferred tax asset - non-current	5,415,755	8,438,67
Other	15,000	15,00
Intangible assets, net	11,737	16,92
Total other assets	31,581,614	8,470,59
TOTAL ASSETS	$ 86,302,756	$ 29,719,04
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 1,045,657	$ 712,79
Accrued liabilities	913,789	1,165,59

Total current liabilities	1,959,446	1,878,39
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY:		
Preferred shares; authorized, 1,000,000 shares of $.01 par value; no shares issued or outstanding	--	-
Common shares; authorized, 20,000,000 shares of $.01 par value; issued and outstanding, 13,095,918 shares at August 31, 2006, and 10,715,885 shares at November 30, 2005	130,959	107,15
Additional paid-in capital	116,287,299	64,864,55
Accumulated deficit	(32,074,948)	(37,131,06
Total shareholders' equity	84,343,310	27,840,65
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 86,302,756	$ 29,719,04

See notes to financial statements

SOMANETICS CORPORATION

STATEMENTS OF OPERATIONS
(UNAUDITED)

	THREE MONTHS ENDED AUGUST 31,		NINE MONTHS ENDED AUGUST 31,	
	2006	2005	2006	2005
NET REVENUES	$ 7,867,739	$ 5,242,848	$21,016,310	$14,358,2
COST OF SALES	1,081,890	661,196	2,716,886	1,856,1
Gross Margin	6,785,849	4,581,652	18,299,424	12,502,0
OPERATING EXPENSES:				
Research, development and engineering	135,063	95,924	454,140	296,4
Selling, general and administrative	4,533,565	3,064,857	11,894,113	8,685,6
Total operating expenses	4,668,628	3,160,781	12,348,253	8,982,0
OPERATING INCOME	2,117,221	1,420,871	5,951,171	3,519,9
OTHER INCOME:				
Interest income	751,523	85,413	1,709,603	189,5
Total other income	751,523	85,413	1,709,603	189,5
NET INCOME BEFORE INCOME TAXES	2,868,744	1,506,284	7,660,774	3,709,4
INCOME TAX PROVISION	975,373	512,136	2,604,663	1,261,2
NET INCOME	$ 1,893,371	$ 994,147	$ 5,056,111	$ 2,448,2

NET INCOME PER COMMON SHARE - BASIC	$ 0.14	$ 0.10	$ 0.41	$ 0.
NET INCOME PER COMMON SHARE - DILUTED	$ 0.13	$ 0.08	$ 0.37	$ 0.
WEIGHTED AVERAGE SHARES OUTSTANDING - BASIC	13,071,340	10,360,990	12,238,600	10,227,9
WEIGHTED AVERAGE SHARES OUTSTANDING - DILUTED	14,460,299	12,102,611	13,713,731	11,850,4

See notes to financial statements

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SOMANETICS CORPORATION

STATEMENTS OF CASH FLOWS
(UNAUDITED)

	FOR THE NINE-MO PERIODS ENDE	
	AUGUST 31, 2006	AUG
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 5,056,111	$ 2,
Adjustments to reconcile net income to net cash provided by operations:		
Income tax provision	2,604,663	1,
Depreciation and amortization	421,416	
Stock compensation expense	125,992	
Changes in assets and liabilities:		
Accounts receivable (increase)	(1,615,644)	(
Inventory (increase)	(1,523,460)	(
Prepaid expenses decrease	475,612	
Accounts payable increase	332,861	
Accrued liabilities increase (decrease)	(251,805)	
Net cash provided by operating activities	5,625,746	3,
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of marketable securities and long-term investments	(48,198,699)	
Acquisition of property and equipment (net)	(509,753)	(
Net cash (used in) investing activities	(48,708,452)	(
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common shares	51,232,774	
Proceeds from issuance of common shares due to exercise of stock options	87,780	1,
Net cash provided by financing activities	51,320,554	1,
NET INCREASE IN CASH AND CASH EQUIVALENTS	8,237,848	4,

CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	13,148,237	7,
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 21,386,085	$11,
Supplemental Disclosure of Non cash investing activities: Demonstration and no capital cost sales equipment capitalized from inventory (Note 2)	$ 551,764	$

See notes to financial statements

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SOMANETICS CORPORATION

NOTES TO FINANCIAL STATEMENTS
(UNAUDITED)

AUGUST 31, 2006

1. FINANCIAL STATEMENT PRESENTATION

We prepared our unaudited interim financial statements pursuant to the Securities and Exchange Commission's rules. These interim financial statements do not include all of the information and notes normally included in our annual financial statements prepared in accordance with generally accepted accounting principles. We believe, however, that the disclosures are adequate to make the information presented not misleading.

The unaudited interim financial statements in this report reflect all adjustments which are, in our opinion, necessary for a fair statement of the results for the interim periods presented. All of these adjustments that are material are of a normal recurring nature. Our operating results for the nine-month period ended August 31, 2006 do not necessarily indicate the results that you should expect for the year ending November 30, 2006. You should read the unaudited interim financial statements together with the financial statements and related notes for the year ended November 30, 2005 included in our Annual Report on Form 10-K for the fiscal year ended November 30, 2005.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Marketable Securities and Long-Term Investments consist of Aaa-rated United States government agency bonds, classified as held to maturity, maturing approximately four months to three years from the date of acquisition, are stated at an amortized cost of $48,198,699, and have a current market value of $48,210,423.

Inventory is stated at the lower of cost or market on a first-in, first-out (FIFO) basis. Inventory consists of:

	AUGUST 31, 2006	NOVEMBER 30, 2005
Purchased components ..	$1,502,309	$ 652,876
Finished goods	427,165	352,560
Work in process	100,323	52,665

Total	$2,029,797	$1,058,101

Property and Equipment are stated at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets, which range from two to five years. Depreciation expense was $416,232 and $271,783 for the nine-month periods ended August 31, 2006 and August 31, 2005, respectively. We offer to our United States customers a no capital cost sales program whereby we ship the INVOS System monitor to the customer at no charge. The INVOS System monitors that are shipped to our customers are classified as no capital cost sales equipment and are depreciated over five years to cost of goods sold. All other depreciation expense is recorded as a selling, general and administrative expense. As of August 31, 2006, we have capitalized $2,395,886 in costs for INVOS System monitors being used as demonstration and no capital cost sales equipment, and these assets had a net book value of $1,367,510. Property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the net book value of the asset may not be recovered.

Intangible Assets consist of patents and trademarks. Patents and trademarks are recorded at cost and are being amortized using the straight-line method over 17 years. The carrying amount and accumulated amortization of these patents and trademarks are as follows:

SOMANETICS CORPORATION

NOTES TO FINANCIAL STATEMENTS- CONTINUED
(UNAUDITED)

AUGUST 31, 2006

	AUGUST 31, 2006	NOVEMBER 30, 2005
Patents and trademarks	$111,733	$111,733
Less: accumulated amortization ..	(99,996)	(94,812)
Total	$ 11,737	$ 16,921

Amortization expense for the nine months ended August 31, 2006 and August 31, 2005 was $5,184. Amortization expense for each of the next two fiscal years is expected to be approximately $6,900 per year, and approximately $3,100 in fiscal 2008.

Stock Compensation In October 1995, Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," was issued. In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised), Share Based Payment. This Statement revises Statement No. 123, "Accounting for Stock-Based Compensation," and requires that compensation costs related to share-based payment transactions, including stock options, restricted stock and restricted stock units be recognized in the financial statements. This Statement became effective for our fiscal quarter that began December 1, 2005.

We previously accounted for stock-based compensation of employees using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, compensation costs for stock options granted to employees were measured as the excess, if any, of the market price of our stock at the date of grant over the amount an employee must pay to acquire the stock. During the first three quarters of fiscal 2005, we recorded no compensation expense against income for stock option grants to employees. Stock-based compensation of consultants and advisors was determined based on the fair value of the options or warrants on the grant date pursuant to the methodology of SFAS No. 123, estimated using the Black-Scholes model. The resulting amount was recognized as compensation expense and an increase in additional paid-in capital over the vesting period of the options or warrants. In the first nine months of fiscal 2005, we recorded such compensation expense of $7,013.

In November 2005, we approved the acceleration of vesting of all unvested stock options as of November 30, 2005. The primary purpose of this accelerated vesting was to eliminate compensation expense we would recognize in our results of operations upon the adoption of SFAS 123(R), which became effective for our fiscal quarter that began December 1, 2005. After the effects of the accelerated vesting, the initial adoption of SFAS 123(R) was immaterial and resulted in no compensation expense in the first three quarters of fiscal 2006 with respect to options granted before December 1, 2005. However, the issuance of additional stock compensation under the 2005 Stock Incentive Plan in the third quarter of fiscal 2006 had an impact on our financial statements.

During the first three quarters of fiscal 2006 we granted 232,000 stock options to our officers, employees, directors and one of our consultants, we issued 68,000 restricted common shares to our officers, and we issued 12,033 newly-issued common shares as a result of stock option exercises. These stock options and restricted shares that were granted vest over five years. As a result of the stock options and restricted common shares that we granted during the nine months ended August 31, 2006, we have recorded $125,992 in stock compensation expense in accordance with SFAS No. 123(R). The fair value of the stock option grants was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: expected volatility (the measure by which the stock price has fluctuated or is expected to fluctuate during the period) 54.00%, risk-free rate of 5%, expected lives of 6 years, and a dividend yield of 0%. The fair value of the restricted common shares was estimated based on the market value of the common shares on the date of issuance.

Had compensation expense for stock options that vested in the third quarter and the first three quarters of fiscal 2005 been determined based on the fair value of the options on the grant date pursuant to the methodology of SFAS No. 123, our results of operations, on a pro forma basis, would have been as follows:

	FOR THE THREE MONTHS ENDED AUGUST 31, 2005
Net income	$ 994,147
Add: Stock-based employee compensation included in actual net income ...	4,208
Deduct: Total stock-based employee compensation, had fair value method been applied	(721,957)
Pro-forma net income	$ 276,398
Net income per common share - diluted	$ .08
Pro-forma net income per common share - diluted, had fair value method been applied	$ .02

Net Income Per Common Share - basic and diluted is computed using the weighted average number of common shares outstanding during each period. Weighted average shares outstanding - diluted includes the potential dilution that could occur for common stock issuable under stock options or warrants. The difference between weighted average shares - diluted and weighted average shares - basic is calculated as follows:

	2006	
	Three Months	Nine Months
Weighted average shares - basic	13,071,340	12,238,600
Add: effect of dilutive common shares and warrants	1,388,959	1,475,131
Weighted average shares - diluted	14,460,299	13,713,731

	2005	
	Three Months	Nine Months
Weighted average shares - basic	10,360,990	10,227,923
Add: effect of dilutive common shares and warrants	1,741,621	1,622,495
Weighted average shares - diluted	12,102,611	11,850,418

For the three and nine months ended August 31, 2006 and 2005, the number of stock options that were excluded from the computation of net income per common share - diluted, because the exercise price of the options exceeded the average price per share of our common shares, was approximately 166,000, and the number of warrants excluded from the calculation was 2,100,000, as they are contingent on achieving specified future sales targets that we do not expect to achieve. As of August 31, 2006 we had outstanding 4,232,699 warrants and options to purchase common shares, and as of August 31, 2005 we had outstanding 4,303,151 warrants and options to purchase common shares.

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SOMANETICS CORPORATION

NOTES TO FINANCIAL STATEMENTS- CONTINUED
(UNAUDITED)

AUGUST 31, 2006

3. ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	AUGUST 31, 2006	NOVEMBER 30, 2005
Incentive Compensation ..	$519,450	$ 701,658
Sales Commissions	222,968	352,459
Professional Fees	96,698	5,625
Clinical Research	47,081	21,675
Warranty	19,150	16,850
Royalty	8,442	13,788
401(k) Match	--	42,164
Taxes	--	11,375
Total	$913,789	$1,165,594

4. COMMITMENTS AND CONTINGENCIES

On April 19, 2006, we amended and restated the employment agreement with our President and Chief Executive Officer that was scheduled to expire on April 30, 2006. The amended and restated agreement provides for severance benefits consisting of fringe benefits for one year, a lump sum payment equal to one year's salary plus the target bonus for the year of termination (which must be at least 65% of his salary), plus a pro rata bonus through the date of termination, plus an amount equal to the cost of his automobile, cellular phone and Internet access for one year upon termination of his employment without cause or for good reason, or if his employment terminates because his agreement expires. His amended and restated employment agreement expires April 30, 2009, unless earlier terminated as provided in the agreement. He has agreed not to compete with us and not to solicit our employees during specified periods following the termination of employment, and he has agreed to various confidentiality and assignment of invention obligations. Upon his termination without cause or if the agreement expires, the estimated financial exposure of this amended and restated employment agreement is approximately $500,000.

We may become subject to products liability claims by patients or physicians, and may become a defendant in products liability or malpractice litigation. We have obtained products liability insurance and an umbrella policy. We might not be able to maintain such insurance or such insurance might not be sufficient to protect us against products liability.

5. COMMON STOCK

On March 6, 2006, we completed a public offering of 2,300,000 of our newly-issued common shares at a public offering price of $24.00 per share. The net proceeds, after deducting the underwriting discount and the expense of the offering, were $51,232,774. These amounts include the exercise in full by the underwriters of an option to purchase up to 300,000 shares to cover over-allotments. At completion of the offering, we had 13,015,885 shares outstanding. We are using, or intend to use, the net proceeds from the offering for the expansion of our direct sales team and other sales and marketing activities, to sponsor additional clinical trials, to expand research and development efforts, and for working capital and general corporate purposes, including potential acquisitions of complementary products, technologies or businesses.

In June 2006, we granted 10-year options under the 2005 Stock Incentive Plan to purchase 166,000 common shares to our officers and three of our directors at an exercise price of $18.06 per share (the average of the high and low sale prices of the common shares as of the date of grant), and issued 68,000 restricted common shares to our officers. In addition, in June 2006 we granted 10-year options under the 2005 Stock Incentive Plan to purchase 66,000 common shares to 18 of our employees, one of our directors and one of our consultants at an exercise price of $15.33 per share (the average of the high and low sale prices of the common shares as of the date of grant).

During the first three quarters of fiscal 2006, we issued 12,033 common shares as a result of stock option exercises by our employees and one of our former directors, for proceeds of $87,780.

6. SEGMENT INFORMATION

We operate our business in one reportable segment, the development, manufacture and marketing of medical devices. Each of our two product lines have similar characteristics, customers, distribution and marketing strategies, and are subject to similar regulatory requirements. In addition, in making operating and strategic decisions, our management evaluates net revenues based on the worldwide net revenues of each major product line, and profitability on an enterprise-wide basis due to shared costs. Approximately 99 percent of our net revenues in the first three quarters of fiscal 2006 were derived from our INVOS System product line, compared to 97 percent of our net revenues in the first three quarters of fiscal 2005.

7. SUBSEQUENT EVENTS

We entered into a Contract Development and Exclusive Licensing Agreement with NeuroPhysics Corporation as of September 18, 2006. The agreement provides us with feasibility research, contract development and consulting services and certain ownership and licensing rights, subject to the rights of the United States Federal government, to intellectual property and technical knowledge associated with several novel near-infrared spectroscopy, or "NIRS", and imaging technologies and products under development at NeuroPhysics. We paid an initial license fee of $1,000,000 and have agreed to pay monthly license fees of up to $30,000 a month (depending on which projects are continuing under development at NeuroPhysics at the time) for products continuing under development at NeuroPhysics beginning April 1, 2008 and a royalty on future sales of the new products.

NeuroPhysics is in the early stage of feasibility research and development of several NIRS-based technologies and products, including a novel approach to depth resolved NIRS measurements. In addition to this NIRS-based, depth-resolved technology, products under development at NeuroPhysics include (1) a fetal cerebral oximetry system, (2) a monitor for measuring oxygen saturation in deep tissues for assessing hemorrhagic shock, (3) devices to assess tumors or swelling containing blood, including in the brain of head trauma victims and neonates with intra-ventricular hemorrhage, (4) a continuous and non-invasive blood gas monitor, and (5) a new imaging concept intended to improve resolution and expand the applicability of endoscopes. We may terminate any or all of the projects under this agreement at any time. We might not be able to develop these technologies or products into commercially viable products, and competitors might develop and market similar products before we do.

SOMANETICS CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

AUGUST 31, 2006

FORWARD-LOOKING STATEMENTS

You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and the related notes and other financial data included elsewhere in this report. Some of the information contained in this discussion and analysis or set forth elsewhere in this report, including information with respect to our plans and strategy for our business, includes forward-looking statements that involve risks and uncertainties. You should review the "Risk Factors" section of our Annual Report on Form 10-K for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis See also "Forward-Looking Statements" in Item 1A of our Annual Report on Form 10-K.

OVERVIEW

We develop, manufacture and market the INVOS System, a non-invasive patient monitoring system that continuously measures changes in blood oxygen levels in the brain. In the first quarter of fiscal 2005, we initiated selling and marketing efforts for the INVOS System in the pediatric intensive care unit, or ICU. We plan to launch the product into the neonatal ICU in early 2007, after completing development of a smaller SomaSensor. We are currently sponsoring a clinical trial evaluating the use of the INVOS System on diabetic patients over age 50. If the results of this trial are positive, we intend to target more actively the sale of the INVOS System for use in diabetic patients undergoing major surgeries, consistent with FDA requirements. We expect to begin this marketing in 2008.

In November 2005, we received 510(k) clearance from the FDA to market our INVOS System to monitor changes in somatic tissue blood oxygen saturation in regions of the body other than the brain in patients with or at risk for restricted blood flow. Our next generation INVOS System monitor, which we launched in the second quarter of 2006, can display information from four SomaSensors, which will allow for the simultaneous monitoring of changes in blood oxygen saturation in the brain and, in patients with or at risk for restricted blood flow, in somatic tissue.

We also develop and market the CorRestore System for use in cardiac repair and reconstruction. In September 2004, the European Economic Community changed its regulations, limiting approval authority for animal tissue implant products sold in Europe to some independent registration agencies that do not include our registrar. Sales of CorRestore Systems represented one percent of our net revenues for the first nine months of fiscal 2006. We expect that as sales of our INVOS System increase, the CorRestore System will become an even less significant component of our business.

NET REVENUES AND COST OF SALES

We derive our revenues from sales of INVOS Systems and CorRestore Systems to hospitals in the United States through our direct sales team and independent sales representative firms. Outside the United States, we have distribution agreements with independent distributors for the INVOS System, including Tyco Healthcare in Europe, Canada, the Middle East and Africa, and Edwards Lifesciences Ltd. in Japan. Our cost of sales represent the cost of producing monitors and disposable SomaSensors. Revenues from outside the United States contributed 21 percent to our net revenues for the first nine months of fiscal 2006. As a percentage of revenues, the gross margins from our international sales are typically lower than gross margins from our U.S. sales, reflecting the difference between the prices we receive from distributors and from direct customers.

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SOMANETICS CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

AUGUST 31, 2006

We offer to our customers in the United States a no capital cost sales program whereby we ship the INVOS System monitor to the customer at no charge. Under this program, we do not recognize any revenue upon the shipment of the monitor. We recognize SomaSensor revenue when we receive purchase orders and ship the product to the customer. At the time of shipment of the monitor, we capitalize the monitor as an asset and depreciate this asset over five years, and this depreciation is included in cost of goods sold.

OPERATING EXPENSES

Selling, general and administrative expenses generally consist of:

- salaries, wages and related expenses of our employees and consultants;

- sales and marketing expenses, such as employee sales commissions, commissions to independent sales representatives, travel, entertainment, advertising, education and training expenses, depreciation of demonstration monitors and attendance at selected medical conferences;

- clinical research expenses, such as costs of supporting clinical trials; and

- general and administrative expenses, such as the cost of corporate operations, professional services, insurance, warranty and royalty expenses, investor relations, depreciation and amortization, facilities expenses and other general operating expenses.

We have increased the size of our direct sales team and expect to continue to increase significantly the number of sales personnel in fiscal 2006. In addition, we are evaluating placing direct salespersons and clinical specialists in Europe to support Tyco Healthcare. We also expect our clinical research expenses to increase in fiscal 2006 as a result of sponsoring a clinical trial evaluating the use of the INVOS System on diabetic patients over age 50. As a result, we expect selling, general and administrative expenses to increase in fiscal 2006.

Research, development and engineering expenses consist of:

- salaries, wages and related expenses of our research and development personnel and consultants;

- costs of various development projects; and

- costs of preparing and processing applications for FDA clearance of new products.

We expect our research, development and engineering expenses to increase as a result of our Contract Development and Exclusive Licensing Agreement with NeuroPhysics Corporation, dated September 18, 2006.

RESULTS OF OPERATIONS

THREE MONTHS ENDED AUGUST 31, 2006 COMPARED TO THREE MONTHS ENDED AUGUST 31, 2005

NET REVENUES. Our net revenues increased $2,624,891, or 50 percent, from $5,242,848 in the three-month period ended August 31, 2005 to $7,867,739 in the three-month period ended August 31, 2006. The increase in net revenues is primarily attributable to:

- an increase in U.S. sales of $1,423,853, or 32 percent, from

$4,414,127 in the third quarter of fiscal 2005 to $5,837,980 in the third quarter of fiscal 2006. The increase in U.S. sales was primarily due to an increase in sales of the disposable SomaSensor of $1,059,270, or 28 percent, primarily as a result of a 21 percent increase in SomaSensor unit sales. In addition, sales of the INVOS System monitor in the United States increased $384,608, or 79 percent, primarily as a result of increased purchases by pediatric hospitals after the launch of our products into the pediatric ICU in the first quarter of fiscal 2005; and

- an increase in international sales of $1,201,039, or 145 percent, from $828,721 in the third quarter of fiscal 2005 to $2,029,760 in the third quarter of fiscal 2006. The increase in international sales was primarily due to purchases of our next generation INVOS System monitor and disposable SomaSensors by Tyco Healthcare in Europe, in connection with the launch of this new monitor in the second quarter. In the third quarter of fiscal 2006, international sales represented 26 percent of our net revenues, compared to 16 percent of our net revenues in the third quarter of fiscal 2005. Purchases by Tyco Healthcare accounted for 23 percent of net revenues in the third quarter of fiscal 2006 and 12 percent of net revenues in the third quarter of fiscal 2005.

In the United States, we sold 50,366 SomaSensors in the third quarter of fiscal 2006, and internationally, we sold 36,920 SomaSensors in the third quarter of fiscal 2006. We placed 98 INVOS System monitors in the United States and 133 internationally in the third quarter of fiscal 2006, and our installed base of INVOS System monitors in the United States was 1,374, in 568 hospitals, as of August 31, 2006.

Sales of our products as a percentage of net revenues were as follows:

PRODUCT	THREE MONTHS ENDED AUGUST 31, 2006	2005
SomaSensors	74%	79%
INVOS System Monitors ..	25%	19%
Total INVOS System ..	99%	98%
CorRestore Systems	1%	2%
Total	100%	100%

Effective December 1, 2005, we increased the suggested list price of the adult SomaSensor and the pediatric SomaSensor in the United States to $140.00 and $155.00, respectively. Although these prices may not apply to existing customers or to any existing sales quotations issued before the price increase was effective, we expect that the average selling price of SomaSensors in the United States will increase in fiscal 2006, primarily as a result of the addition of new customers at our suggested retail prices and increased sales of our pediatric SomaSensor.

GROSS MARGIN. Gross margin as a percentage of net revenues was 86 percent for the three months ended August 31, 2006 and 87 percent for the three months ended August 31, 2005. The decrease in gross margin percentage is primarily attributable to increased purchases of our next generation INVOS System monitor and disposable sensor by Tyco Healthcare, due to the lower margin we receive on sales to our distributors. This decrease was partially offset by a six percent increase in the average selling price of SomaSensors in the United States and increased sales of the INVOS System monitors to pediatric hospitals in the United States. The increase in our average selling prices is attributable to increased sales of our pediatric SomaSensor, which sells for a higher price than the adult SomaSensor, and to the addition of new customers at our higher suggested retail prices.

RESEARCH, DEVELOPMENT AND ENGINEERING EXPENSES. Our research, development and engineering expenses increased $39,139, or 41 percent, from $95,924 in the third quarter of fiscal 2005 to $135,063 in the third quarter of fiscal 2006. The increase is primarily attributable to a $19,207 increase in development costs associated with our next generation INVOS System monitor, which was launched in the second quarter of fiscal 2006, and an $18,973 increase in salaries due to the addition of one engineer. We expect our research, development and engineering expenses to increase in fiscal 2006, primarily as a result of development costs associated with our new smaller pediatric SomaSensor.

We expect our research, development and engineering expenses to increase as a result of our Contract Development and Exclusive Licensing Agreement with NeuroPhysics Corporation, dated September 18, 2006.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses increased $1,468,708, or 48 percent, from $3,064,857 for the three months ended August 31, 2005 to $4,533,565 for the three months ended August 31, 2006, primarily due to:

- a $529,230 increase in salaries, wages and related expenses, primarily as a result of an increase in the number of employees, principally in sales and marketing (from an average of 43 employees for the three months ended August 31, 2005 to an average of 55 employees for the three months ended August 31, 2006) and an increase in salaries of existing employees;

- a $217,482 increase in commissions paid to our sales employees as a result of increased sales and hiring additional sales employees;

- a $164,294 increase in accrued incentive compensation expense due to our year-to-date 2006 financial performance, primarily increased sales and net income in accordance with the 2006 Incentive Compensation Plan;

- a $160,172 increase in professional service fees, primarily due to increased legal and consulting fees;

- a $153,136 increase in travel, marketing and selling-related expenses as a result of our increased sales personnel and increased sales and marketing activities, primarily trade shows and sales training; and

- a $121,784 increase in stock compensation expense due to stock compensation issued to directors, officers, employees and a consultant in the third quarter.

We expect our selling, general and administrative expenses to increase in fiscal 2006, primarily as a result of our hiring additional direct sales personnel in fiscal 2005 and 2006, increased sales commissions payable as a result of increased sales, increased clinical research expense, increased stock compensation expenses due to third quarter stock compensation, and increased sales and marketing expenses.

OTHER INCOME. During the third quarter of fiscal 2006, interest income increased to $751,523, from $85,413 in the third quarter of 2005, primarily due to our increased cash, cash equivalents, marketable securities and long-term investment balances as a result of the proceeds from our public offering of common shares that closed in the second quarter, and increased interest rates.

INCOME TAX PROVISION. During the third quarter of fiscal 2006 and 2005, we recognized income tax expense at an estimated effective tax rate of 34 percent on our statement of operations, and we expect this to continue for future periods.

NINE MONTHS ENDED AUGUST 31, 2006 COMPARED TO NINE MONTHS ENDED AUGUST 31, 2005

NET REVENUES. Our net revenues increased $6,658,099, or 46 percent, from $14,358,211 in the nine-month period ended August 31, 2005 to $21,016,310 in the nine-month period ended August 31, 2006. The increase in net revenues is primarily attributable to:

- an increase in U.S. sales of $4,543,038, or 38 percent, from $11,976,210 in the first nine months of fiscal 2005 to $16,519,248 in the first nine months of fiscal 2006. The increase in U.S. sales was primarily due to an increase in sales of the disposable SomaSensor of $3,683,230, or 36 percent, primarily as a result of a 29 percent increase in SomaSensor unit sales. In addition, sales of the INVOS System monitor in the United States increased $937,483, or 61 percent, primarily as a result of increased purchases by pediatric hospitals after the launch of our products into the pediatric ICU in the first quarter of fiscal 2005; and

- an increase in international sales of $2,115,061, or 89 percent, from $2,382,001 in the first nine months of fiscal 2005 to $4,497,062 in the first nine months of fiscal 2006. The increase in international sales was primarily due to increased purchases of the INVOS System monitor and disposable SomaSensors by Tyco Healthcare in Europe. This increase included the purchases of our next generation INVOS System monitor by Tyco Healthcare in Europe, in connection with the launch of this new monitor in the second quarter, partially for evaluation and demonstration purposes. In the first nine months of fiscal 2006, international sales represented 21 percent of our net revenues, compared to 17 percent of our net revenues in the first nine months of fiscal 2005. Purchases by Tyco Healthcare accounted for 17 percent of net revenues in the first nine months of fiscal 2006 and 12 percent of net revenues in the first nine months of fiscal 2005.

In the United States, we sold 145,037 SomaSensors in the first nine months of fiscal 2006, and internationally, we sold 70,410 SomaSensors. We placed 274 INVOS System monitors in the United States and 360 internationally in the first nine months of fiscal 2006.

Sales of our products as a percentage of net revenues were as follows:

	NINE MONTHS ENDED AUGUST 31,	
PRODUCT	2006	2005
SomaSensors	74%	77%
INVOS System Monitors ..	25%	20%
Total INVOS System ..	99%	97%
CorRestore Systems	1%	3%
Total	100%	100%

GROSS MARGIN. Gross margin as a percentage of net revenues was 87 percent for the nine months ended August 31, 2006 and 87 percent for the nine months ended August 31, 2005. While gross margins as a percentage of net revenues remained fairly constant for the first nine months of fiscal 2006 compared to the first nine months of fiscal 2005, we realized a six percent increase in the average selling price of SomaSensors in the United States and increased sales of the INVOS System monitors to pediatric hospitals in the United States, offset by the purchases of our next generation INVOS System monitor and disposable sensor by Tyco Healthcare, due to the lower margin we receive on sales to our distributors. The increase in our average selling prices in the United States is attributable to increased sales of our pediatric SomaSensor, which sells for a higher price than the adult SomaSensor, and the addition of new customers at our higher suggested retail prices.

RESEARCH, DEVELOPMENT AND ENGINEERING EXPENSES. Our research, development and engineering expenses increased $157,699, or 53 percent, from $296,441 in the first three quarters of fiscal 2005 to $454,140 in the first three quarters of fiscal 2006. The increase is primarily attributable to $95,172 in development costs associated with our next generation INVOS System monitor, which was launched in the second quarter of fiscal 2006, and a $59,607 increase in salaries due to the addition of one engineer.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses increased $3,208,465, or 37 percent, from $8,685,648 for the nine months ended August 31, 2005 to $11,894,113 for the nine months ended August 31, 2006, primarily due to:

- a $1,199,689 increase in salaries, wages and related expenses, primarily as a result of an increase in the number of employees, principally in sales and marketing (from an average of 40 employees for the nine months ended August 31, 2005 to an average of 59 employees for the nine months ended August 31, 2006) and an increase in salaries of existing employees;

- a $574,406 increase in travel, marketing and selling-related expenses as a result of our increased sales personnel and increased sales and marketing activities, primarily trade shows and sales training;

- a $392,497 increase in employee sales commissions as a result of increased sales and hiring additional sales employees in the first nine months of fiscal 2006;

- a $344,462 increase in professional service fees primarily due to increased legal and consulting fees;

- a $165,037 increase in accrued incentive compensation expense due to our year-to-date 2006 financial performance, primarily increased sales and net income in accordance with the 2006 Incentive Compensation Plan;

- a $139,534 increase in commissions paid to our independent sales representative firms as a result of increased sales;

- a $118,979 increase in stock compensation expense due to stock compensation issued to directors, officers, employees and a consultant in the third quarter; and

- a $118,095 increase in office and facilities expenses primarily as a result of increased employees and increased insurance costs.

OTHER INCOME. During the first nine months of fiscal 2006, interest income increased to $1,709,603 from $189,542 in the first nine months of 2005, primarily due to our increased cash, cash equivalents, marketable securities and long-term investment balances as a result of the proceeds from our public offering of common shares that closed in the second quarter, and increased interest rates.

INCOME TAX PROVISION. During the first nine months of fiscal 2006 and 2005, we recognized income tax expense at an estimated effective tax rate of 34 percent on our statement of operations, and we expect this to continue for future periods.

LIQUIDITY AND CAPITAL RESOURCES

GENERAL

Our principal sources of operating funds have been the proceeds of equity investments from sales of our common shares and cash provided by operating activities.

SOMANETICS CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

AUGUST 31, 2006

As of August 31, 2006, we did not have any outstanding or available debt financing arrangements, we had working capital of $50.8 million and our primary sources of liquidity were $21.4 million of cash and cash equivalents, $22.1 million of marketable securities and $26.1 million of long-term investments. Marketable securities and long-term investments consist of Aaa-rated United States Government agency bonds, and cash and cash equivalents are currently invested in bank savings accounts and money market accounts, pending their ultimate use.

On March 6, 2006, we completed a public offering of 2,300,000 of our newly-issued common shares at a public offering price of $24.00 per share. The net proceeds, after deducting the underwriting discount and the expense of the offering, were $51,232,774. These amounts include the exercise in full by the underwriters of an option to purchase up to 300,000 shares to cover over-allotments. At completion of the offering, we had 13,015,885 shares outstanding. We are using, or intend to use, the net proceeds from the offering for the expansion of our direct sales team and other sales and marketing activities, to sponsor additional clinical trials, to expand research and development efforts, and for working capital and general corporate purposes, including potential acquisitions of complementary products, technologies or businesses.

We believe that cash, cash equivalents, marketable securities and long-term investments on hand at August 31, 2006 will be adequate to satisfy our operating and capital requirements for more than the next twelve months.

We entered into a Contract Development and Exclusive Licensing Agreement with NeuroPhysics Corporation as of September 18, 2006. The agreement provides us with feasibility research, contract development and consulting services and certain ownership and licensing rights, subject to the rights of the United States Federal government, to intellectual property and technical knowledge associated with several novel near-infrared spectroscopy, or "NIRS", and imaging technologies and products under development at NeuroPhysics. We paid an initial license fee of $1,000,000 and have agreed to pay monthly license fees of up to $30,000 a month (depending on which projects are continuing under development at NeuroPhysics at the time) for products continuing under development at NeuroPhysics beginning April 1, 2008 and a royalty on future sales of the new products.

CASH FLOWS FROM OPERATING ACTIVITIES

Net cash provided by operations during the first nine months of fiscal 2006 and 2005 was $5,625,746 and $3,324,155, respectively. In the first nine months of fiscal 2006, cash was provided primarily by:

- $8,208,182 of net income before income taxes and non-cash depreciation, amortization, and stock compensation expense;

- a $475,612 decrease in prepaid expenses, primarily because we capitalized to machinery and equipment tooling that was completed in the first six months of fiscal 2006 for our next generation INVOS System monitor, and the amortization of prepaid insurance payments made in fiscal 2005; and

- a $332,861 increase in accounts payable, primarily as a result of increased inventory and operating expenses, partially offset by more timely payments made to vendors.

Cash provided by operations in the first nine months of fiscal 2006 was partially offset by:

- a $1,615,644 increase in accounts receivable, primarily as a result of higher third quarter sales in fiscal 2006 than in the fourth quarter of fiscal 2005 and increased international sales which are generally collected more slowly;

- a $1,523,460 increase in inventories, primarily due to the acquisition of components associated with the launch of our next generation INVOS System monitor and SomaSensors and components associated with our INVOS System monitor due to anticipated sales; inventories on our balance sheet increased less because we capitalized INVOS System monitors to property and equipment that are being used as demonstration units and no capital cost sales equipment, as described below; and

- a $251,805 decrease in accrued liabilities, primarily as a result of the payment of year-end 2005 accrued incentive compensation, accrued 401(k) Plan matching contributions and accrued sales commissions, partially offset by increased accrued professional fees, primarily legal and consulting fees.

We expect our working capital requirements to increase as sales increase.

The increase in inventories described above is greater than shown on our balance sheet because it includes INVOS System monitors that we capitalized because they are being used as demonstration units and no capital cost sales equipment. We capitalized $551,764 of costs from inventory for INVOS System monitors being used as demonstration units and no capital cost sales equipment at customers during the first nine months of fiscal 2006, compared to $390,150 in the first nine months of fiscal 2005. As of August 31, 2006, we had capitalized $2,395,886 in costs for INVOS System monitors being used as demonstration and no capital cost sales equipment, and these assets had a net book value of $1,367,510. We depreciate these assets over five years.

CASH FLOWS FROM INVESTING ACTIVITIES

Net cash used in investing activities in the first three quarters of fiscal 2006 and 2005 was $48,708,452 and $119,543, respectively. In the first three quarters of fiscal 2006, these expenditures were primarily for investments in marketable securities and long-term investments with the proceeds from our public offering, described above, and also $509,753 in capital expenditures, primarily tooling for the next generation INVOS System monitor.

CASH FLOWS FROM FINANCING ACTIVITIES

Net cash provided by financing activities in the first three quarters of fiscal 2006 and 2005 was $51,320,554 and $1,424,970, respectively. On March 6, 2006, we completed a public offering of 2,300,000 of our newly-issued common shares at a public offering price of $24.00 per share. The net proceeds, after deducting the underwriting discount and the expense of the offering, were $51,232,774. In addition, in the first three quarters of fiscal 2006, we issued 12,033 common shares as a result of stock option exercises, for proceeds of $87,780.

CONTRACTUAL OBLIGATIONS

As of August 31, 2006, there have been no material changes outside the ordinary course of business in the contractual obligations disclosed in our Annual Report on Form 10-K for the fiscal year ended November 30, 2005 under the caption "Contractual Obligations."

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements or financing activities.

CRITICAL ACCOUNTING POLICIES

We believe our most significant accounting policies relate to our accounting treatment of stock compensation of employees, our accounting treatment for income taxes, and our revenue recognition associated with our no capital cost sales program.

STOCK COMPENSATION

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised), Share Based Payment. This Statement requires that compensation costs related to share-based payment transactions, including stock options, stock appreciation rights and restricted stock be recognized in the financial statements. This Statement became effective for our fiscal quarter that began December 1, 2005.

We previously accounted for stock-based compensation of employees using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, compensation costs for stock options granted to employees are measured as the excess, if any, of the market price of our stock at the date of the grant over the amount an employee must pay to acquire the stock. No compensation expense has been charged against income in the first three quarters of fiscal 2005 for stock option grants to employees because our stock option grants are priced at the market value as of the date of grant. Stock-based compensation of consultants and advisors was determined based on the fair value of the options or warrants on the grant date pursuant to the methodology of SFAS No. 123, estimated using the Black-Scholes model. The resulting amount was recognized as compensation expense and an increase in additional paid-in capital over the vesting period of the options or warrants. In the first nine months of fiscal 2005, we recorded such compensation expense of $7,013.

In November 2005, we approved the acceleration of vesting of all unvested stock options as of November 30, 2005. The primary purpose of this accelerated vesting was to eliminate compensation expense we would recognize in our results of operations upon the adoption of SFAS 123(R), which became effective for our fiscal quarter that began December 1, 2005. After the effects of the accelerated vesting, the initial adoption of SFAS 123(R) has been immaterial with respect to options granted before December 1, 2005. The issuance of additional stock compensation under the 2005 Stock Incentive Plan in the third quarter of fiscal 2006 had an impact on our financial statements.

During the first three quarters of fiscal 2006 we granted 232,000 stock options to our officers, employees, directors and one of our consultants, and we issued 68,000 restricted common shares to our officers. These stock options and restricted shares vest over five years. As a result of the stock options and restricted common shares that we granted during the nine months ended August 31, 2006, we have recorded $125,992 in stock compensation expense in accordance with SFAS No. 123(R). The fair value of the stock option grants was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: expected volatility (the measure by which the stock price has fluctuated or is expected to fluctuate during the period) 54.00%, risk-free rate of 5%, expected lives of 6 years, and a dividend yield of 0%. The fair value of the restricted common shares was estimated based on the market value of the common shares on the date of issuance.

Had we recognized compensation expense for our stock options that vested in the first three quarters of fiscal 2005 using the fair value method of accounting based on the fair value of the options on the grant date using the Black-Scholes valuation model, we would have recorded $1,315,687 in compensation expense (including the $7,013 actually recorded) and realized pro forma net income of $1,139,582, or $.10 per diluted common share.

INCOME TAXES

We have performed the required assessment of positive and negative evidence regarding realization of our deferred tax assets in accordance with SFAS No. 109, including our past operating results, the existence of cumulative losses over our history up to the most recent three fiscal years, and our forecast for future net income. Our assessment of our deferred tax assets, and the reversal of part of our valuation allowance, included assuming that our net revenues and pre-tax income will grow in future years consistent with the growth guidance given for fiscal 2006 and making allowance for the uncertainties surrounding, among other things, our future rate of growth in net revenues, the rate of adoption of our products in the marketplace, and the potential for competition to enter the marketplace. In reversing a portion of our valuation allowance, in fiscal 2005 and fiscal 2004, we have concluded that it is more likely than not that approximately $10,000,000 of such assets will be realized.

During fiscal 2004, we adjusted our deferred tax asset valuation allowance resulting in the recognition of a deferred tax asset of $6,700,000 related to the expected future benefits of our net operating loss carryforwards, in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." During fiscal 2005, we further adjusted our deferred tax asset valuation allowance resulting in the recognition of an additional net deferred tax asset of $3,300,000.

The effect of recognizing this asset on our balance sheet, and associated tax benefit on our statement of operations, is to increase our net income for fiscal 2005 to $7,751,087, or $0.66 per diluted common share, and to increase our net income for fiscal 2004 to $8,706,576, or $0.77 per diluted common share. Given the assumptions inherent in our financial plans, it is possible to calculate a different value for our deferred tax asset by changing one or more of the variables in our assessment. However, we believe that our evaluation of our financial plans was reasonable, and that the judgments and assumptions that we made at the time of developing the plan were appropriate.

NO CAPITAL COST SALES REVENUE RECOGNITION

We offer to our customers in the United States a no capital cost sales program whereby we ship the INVOS System monitor to the customer at no charge. Under this program, we do not recognize any revenue upon the shipment of the INVOS System monitor. We recognize SomaSensor revenue when we receive purchase orders and ship the product to the customer. At the time of shipment of the monitor, we capitalize the INVOS System monitor as an asset and depreciate this asset over five years. We believe this is consistent with our stated revenue recognition policy, which is compliant with Staff Accounting Bulletin No. 104 and Emerging Issues Task Force No. 00-21, "Revenue Arrangements with Multiple Deliverables."

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The table below provides information about our financial instruments that are sensitive to changes in interest rates, consisting of investments in United States government agency bonds. For these financial instruments, the table presents principal cash flows and related weighted average interest rates by expected maturity dates. Weighted average fixed rates are based on the contract rates. The actual cash flows of all instruments are denominated in U.S. dollars. We invest our cash on hand not needed in current operations in United States government agency bonds with varying maturity dates with the intention of holding them until maturity.

	AUGUST 31, 2006 EXPECTED MATURITY DATES BY FISCAL YEAR					
	2006	2007	2008	2009	2010	TH
INVESTMENTS:						
Marketable Securities and						

Long-term Investments:					
Fixed Rate ($).............	5,057,026	21,037,872	12,011,647	10,092,154	--
Average interest rate...	5.11%	5.16%	5.25%	5.33%	N/A

ITEM 4. CONTROLS AND PROCEDURES

Our management has evaluated, with the participation of our principal executive and principal financial officers, the effectiveness of our disclosure controls and procedures as of August 31, 2006 and any change in our internal control over financial reporting that occurred during our third fiscal quarter ended August 31, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Based on their evaluation, our principal executive and principal financial officers have concluded that these controls and procedures are effective as of August 31, 2006. There was no change in our internal control over financial reporting identified in connection with such evaluation that occurred during our third fiscal quarter ended August 31, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Internal control over financial reporting is a process designed by, or under the supervision of, our principal executive and principal financial officers, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our transactions and dispositions of assets, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors, and (3) and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

PART II OTHER INFORMATION

ITEM 6. EXHIBITS

10.1 Contract Development and Exclusive Licensing Agreement, dated as of September 18, 2006, among Somanetics Corporation, NeuroPhysics Corporation, Hugh F. Stoddart, and Hugh A. Stoddart, incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K, dated September 18, 2006 and filed September 20, 2006.

10.2 Summary of Outside Director Compensation, incorporated by reference to Item 1.01 to the Company's Current Report on Form 8-K dated June 29, 2006 and filed July 5, 2006.

31.1 Certifications of Chief Executive Officer Pursuant to Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certifications of Chief Financial Officer Pursuant to Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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.

Somanetics Corporation
(Registrant)

Date: October 6, 2006

By: /s/ William M. Iacona

William M. Iacona
Vice President and Chief Financial Officer, Controller and Treasurer
(Duly Authorized and Principal Financial Officer)

EXHIBIT INDEX

Exhibit	Description
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