CUTERA INC
Form 10-Q
May 07, 2007
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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 March 31, 2007

OR

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

Commission file number: 000-50644

Cutera, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**77-0492262**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. employer identification no.)**

3240 Bayshore Blvd., Brisbane, California 94005

(Address of principal executive offices)

(415) 657-5500

(Registrant s telephone number, including area code)

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

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

Large accelerated filer ¨ Accelerated filer 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

The number of shares of Registrant s common stock issued and outstanding as of April 30, 2007 was 13,550,880

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CUTERA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

(unaudited)

	March 31, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 16,876	$ 11,800
Marketable investments	94,363	96,285
Accounts receivable, net	8,565	9,601
Inventories	6,516	5,220
Deferred tax asset	5,809	5,792
Other current assets	3,488	2,702
Total current assets	135,617	131,400
Property and equipment, net	1,212	1,029
Intangibles, net	1,398	1,446
Deferred tax asset, net of current portion	361	
Total assets	$ 138,588	$ 133,875
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts payable	$ 1,893	$ 2,212
Accrued liabilities	11,615	13,675
Deferred revenue	3,780	3,514
Total current liabilities	17,288	19,401
Deferred rent	1,478	1,424
Deferred revenue, net of current portion	3,192	3,258
Income tax liability	1,018	60
Total liabilities	22,976	24,143
Commitments and Contingencies (Note 8)		
Stockholders equity:		
Common stock	13	13
Additional paid-in capital	90,304	86,242
Deferred stock-based compensation	(190)	(331)
Retained earnings	25,530	23,866
Accumulated other comprehensive loss	(45)	(58)

Total stockholders equity	115,612	109,732
Total liabilities and stockholders equity	$ 138,588	$ 133,875

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

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CUTERA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended March 31,	
	2007	**2006**
Net revenue	$ 23,257	$ 20,757
Cost of revenue	7,781	5,811
Gross profit	15,476	14,946
Operating expenses:		
Sales and marketing	9,063	8,546
Research and development	1,747	1,307
General and administrative	3,018	4,375
Total operating expenses	13,828	14,228
Income from operations	1,648	718
Interest and other income, net	1,002	956
Income before income taxes	2,650	1,674
Provision for income taxes	895	567
Net income	$ 1,755	$ 1,107
Net income per share:		
Basic	$ 0.13	$ 0.09
Diluted	$ 0.12	$ 0.08
Weighted-average number of shares used in per share calculations:		
Basic	13,216	12,257
Diluted	14,629	14,174

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

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CUTERA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended March 31,	
	2007	2006
Cash flows from operating activities:		
Net income	$ 1,755	$ 1,107
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	226	199
Change in allowance for doubtful accounts	62	83
Provision for excess and obsolete inventories	18	
Change in deferred tax asset	60	22
Stock-based compensation	1,342	1,086
Tax benefit from stock options	710	1,006
Excess tax benefit related to stock-based compensation expense	(288)	(999)
Changes in assets and liabilities:		
Accounts receivable	974	(252)
Inventories	(1,314)	(1,439)
Other current assets	(786)	(212)
Accounts payable	(319)	1,035
Accrued liabilities	(1,605)	(258)
Deferred rent	54	82
Deferred revenue	200	652
Income tax liability	(26)	
Net cash provided by operating activities	1,063	2,112
Cash flows from investing activities:		
Acquisition of property and equipment	(341)	(114)
Acquisition of intangibles	(20)	
Proceeds from sales of marketable investments	15,149	439
Proceeds from maturities of marketable investments	7,630	18,688
Purchase of marketable investments, net	(20,844)	(24,989)
Net cash provided by (used in) investing activities	1,574	(5,976)
Cash flows from financing activities:		
Proceeds from exercise of stock options and employee stock purchase plan	2,151	556
Excess tax benefit related to stock-based compensation expense	288	999
Net cash provided by financing activities	2,439	1,555
Net increase (decrease) in cash and cash equivalents	5,076	(2,309)
Cash and cash equivalents at beginning of period	11,800	5,260
Cash and cash equivalents at end of period	$ 16,876	$ 2,951

Non-cash disclosure of cash flow information:		
Change in deferred stock-based compensation, net of terminations	$ (8)	$ (1,255)

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

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CUTERA, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Description of Operations

Cutera Inc., or Cutera or the Company, is a Delaware corporation headquartered in Brisbane, California. The Company is a global provider of laser and other light-based aesthetic systems for practitioners worldwide. The Company, designs, develops, manufactures, markets and services the CoolGlide, Xeo and Solera platforms for use by dermatologists, plastic surgeons, gynecologists, primary care physicians, and other qualified practitioners to offer safe, effective and non-invasive aesthetic treatments to their customers. The Company has wholly-owned subsidiaries in Australia, Canada, France, Germany, Japan, Spain, Switzerland and United Kingdom. The purpose of these subsidiaries is to market, sell and service the Company s products outside of the United States.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated.

Unaudited Interim Financial Information

The financial information furnished is unaudited. The Condensed Consolidated Financial Statements included in this report reflect all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for the fair statement of the results of operations for the interim periods covered and of the financial condition of the Company at the date of the interim balance sheet. The December 31, 2006 Condensed Balance Sheet was derived from audited financial statements, but does not include all disclosure required by accounting principles generally accepted in the United States of America. The results for interim periods are not necessarily indicative of the results for the entire year or any other interim period. The Condensed Consolidated Financial Statements should be read in conjunction with the Company s financial statements and the notes thereto included in the Company s annual report on Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission, or SEC, on March 16, 2007.

Use of Estimates

The preparation of interim Condensed Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States requires the Company s management to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. Actual results could differ materially from those estimates. On an ongoing basis, the Company evaluates their estimates, including those related to the accounts receivable and sales allowances, fair values of marketable investments, fair values of acquired intangible assets, useful lives of intangible assets and property and equipment, fair values of options to purchase the Company s common stock, recoverability of deferred tax assets, and effective income tax rates, among others. 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.

Significant Accounting Policies

The Company s significant accounting policies are disclosed in the Company s annual report on Form 10-K for the year ended December 31, 2006 and have not changed significantly as of March 31, 2007, except for the following:

Accounting for Income Taxes

In July 2006, the Financial Accounting Standards Board, or FASB, issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, or FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with Statement of Financial Accounting Standards, or SFAS, No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FIN 48 effective January 1, 2007. Refer to Note 7 for further details of the impact of

adoption.

Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities or SFAS No. 159, which permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 also includes an amendment to SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, which applies to all entities with available-for-sale and trading securities. This statement is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. The Company is currently assessing the potential impact of implementing this standard on its consolidated financial position, results of operations and cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements,* or SFAS No. 157. This standard defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America, and expands disclosure about fair value measurements. This pronouncement applies under other accounting standards that require or permit fair value measurements. Accordingly, this statement does not require any new fair value measurement. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company will be required to adopt SFAS 157 in the quarter ended March 31, 2008. The Company is currently assessing the impact that SFAS 157 may have on its consolidated financial position, results of operations and cash flows.

Note 2. Balance Sheet Details

Cash, Cash Equivalents and Marketable Investments:

The Company considers all highly liquid investments, with an original maturity of three months or less at the time of purchase, to be cash equivalents. Investments in debt securities are accounted for as available-for-sale securities, carried at fair value with unrealized gains and losses reported in other comprehensive income, held for use in current operations and classified in current assets as Marketable Investments.

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The following is a summary of cash, cash equivalents and marketable investments:

March 31, 2007 (in thousands)	Amortized Cost	Gross Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and cash equivalents	$ 16,876	$	$	$ 16,876
Marketable investments	94,408		(45)	94,363
	$ 111,284	$	$ (45)	$ 111,239

December 31, 2006 (in thousands)	Amortized Cost	Gross Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and cash equivalents	$ 11,800	$	$	$ 11,800
Marketable investments	96,343		(58)	96,285
	$ 108,143	$	$ (58)	$ 108,085

Inventories:

Inventories consist of the following (in thousands):

	March 31, 2007	December 31, 2006
Raw materials	$ 3,881	$ 2,816
Finished goods	2,635	2,404
	$ 6,516	$ 5,220

Intangible Assets:

Intangible assets are principally comprised of a technology sublicense acquired in 2002; a patent sublicense acquired in 2006; and other intangibles. The components of intangible assets were as follows (in thousands):

	March 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Patent sublicense	$ 1,218	$ 138	$ 1.080
Technology sublicense	538	261	277
Other intangibles	185	144	41
Total	$ 1,941	$ 543	$ 1,398

	December 31, 2006		
	Gross Carrying Amount	Accumulated Amortization Amount	Net Amount
Patent sublicense	$ 1,218	$ 104	$ 1,114
Technology sublicense	538	247	291
Other intangibles	165	124	41
Total	$ 1,921	$ 475	$ 1,446

For the three months ended March 31, 2007 and 2006, amortization expense for intangible assets was $68,000 and $35,000, respectively.

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Based on intangible assets recorded at March 31, 2007, and assuming no subsequent additions to, or impairment of the underlying assets, the remaining estimated annual amortization expense is expected to be as follows (in thousands):

Fiscal year ending December 31:	
2007 remainder	$ 169
2008	202
2009	197
2010	192
2011	192
Thereafter	446
Total	$ 1,398

Note 3. Share-based Compensation

The pre-tax stock-based compensation expense recognized during the quarter ended March 31, 2007 and 2006 was as follows (in thousands):

	Three Months Ended March 31,	
	2007	**2006**
Cost of sales	$ 232	$ 171
Sales and marketing	447	402
Research and development	207	160
General and administrative	456	354
Total stock-based compensation expense	$ 1,342	$ 1,086

Note 4. Net Income Per Share

Basic net income per share is calculated by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is calculated by using the weighted-average number of common shares outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the dilutive potential shares of common stock had been issued. The dilutive effect of outstanding options, Employee Stock Purchase Plan, or ESPP, shares and restricted stock units is reflected in diluted earnings per share by application of the treasury stock method, which includes consideration of stock-based compensation required by Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment (revised 2004)*, or SFAS 123(R), and SFAS No. 128, *Earnings Per Share.*

The following table sets forth the computation of basic and diluted net income and the weighted average number of shares used in computing basic and diluted net income per share (in thousands):

	Three Months Ended March 31,	
	2007	**2006**
Numerator:		
Net income available to common stockholders Basic and Diluted	$ 1,755	$ 1,107
Denominator:		
Weighted-average number of common shares outstanding used in computing basic net income per share	13,216	12,257
Dilutive potential common shares used in computing diluted net income per share	1,413	1,917

Total weighted-average number of shares used in computing diluted net income per share	14,629	14,174

Anti-dilutive securities

The following number of outstanding options, prior to the application of the treasury stock method, were excluded from the computation of diluted net income per common share for the periods presented because including them would have had an anti-dilutive effect (in thousands):

	Three Months Ended March 31,	
	2007	2006
Options to purchase common stock		309

Note 5. Service Contract Revenue

Service contract revenue is recognized on a straight-line basis over the period of the applicable service contract. The deferred service contract revenue balances as of March 31, 2007 and December 31, 2006, were as follows (in thousands):

	March 31, 2007	March 31, 2006
Balance at December 31, 2006 and 2005	$ 6,652	$ 3,117
Add: Payments received	1,551	1,441
Less: Revenue recognized	(1,352)	(786)
Balance at March 31, 2007 and 2006	$ 6,851	$ 3,772

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Costs incurred under service contracts during the three months ended March 31, 2007 and 2006, amounted to $464,000 and $402,000, respectively. All service contract costs are recognized as incurred.

Note 6. Comprehensive Income

Comprehensive income generally represents all changes in stockholders equity except those resulting from investments or contributions by stockholders. The Company s unrealized gain (loss) on marketable investments represents the only component of other comprehensive income that is excluded from net income. The changes in components of other comprehensive income for the periods presented are as follows (in thousands):

	Three Months Ended March 31,	
	2007	2006
Net income	$ 1,755	$ 1,107
Unrealized gain (loss) on marketable investments	13	(38)
Comprehensive income	$ 1,768	$ 1,069

Note 7. Income Tax

The interim effective income tax rate is based on management s best estimate of the annual effective income tax rate. The effective tax rate for both the three months ended March 31, 2007 and 2006 was 34%. This rate reflects applicable United States federal and state tax rates and the tax impact of foreign operations, offset primarily by research and development tax credits (in the three months ended March 31, 2007 only) and tax exempt interest income.

Undistributed earnings of the Company s foreign subsidiaries of approximately $1,489,000 and $590,000 at March 31, 2007 and 2006, respectively, are considered to be indefinitely reinvested and, accordingly, no provision for federal and state income taxes has been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, the Company would be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to various foreign countries.

Impact of adoption of FIN 48

The Company implemented the provisions of FIN 48 as of January 1, 2007 and recorded the cumulative effect of applying the provisions of the Interpretation as an adjustment to the Company s retained earnings balance as of January 1, 2007. The total amount of unrecognized tax benefits as of the date of adoption was approximately $943,000. The Company reduced its January 1, 2007 retained earnings by approximately $91,000.

Included in the balance of unrecognized tax benefits at January 1, 2007, are approximately $542,000 of tax benefits that, if recognized, would affect the effective tax rate; and approximately $401,000 of tax benefits that, if recognized, would result in an adjustment to deferred tax assets.

Accrued interest and penalties relating to the income tax on the unrecognized tax benefits as of March 31, 2007 and January 1, 2007, was approximately $107,000 and $93,000, respectively, with approximately $14,000 being included as a component of provision for income taxes in the quarter ended March 31, 2007.

In general, the Company s income tax returns are subject to examination by U.S. federal, state and foreign tax authorities for tax years 2002 forward. The Company does not expect that the amounts of unrecognized tax benefits will change significantly within the next 12 months.

Note 8. Commitments and Contingencies

Litigation

The Company received notice that a purported securities class action lawsuit was filed on April 17, 2007 against it and two of its officers in the U.S. District Court for the Northern District of California. The plaintiff claims to represent purchasers of the Company s common stock from January 31, 2007 through April 4, 2007. The complaint generally alleges that materially false statements were made regarding its financial

prospects, and seeks unspecified monetary damages. The Company intends to defend this case vigorously. Since the outcome of the litigation is unpredictable, and since the Company believes that a significant adverse result is not probable, no expense has been recorded with respect to the contingent liability associated with this matter. The Company retains director and officer liability insurance but there is no assurance that such insurance will cover the claims that are made or will insure the Company fully for all losses on covered claims.

Other Legal Matters

In addition to the foregoing lawsuit, the Company is named from time to time as a party to product liability and contractual lawsuits in the normal course of its business. As of March 31, 2007, the Company is not a party to any material pending litigation.

Facility Leases

The Company leases its office and manufacturing facility in Brisbane, California, and also leases offices in Japan, Switzerland and France under operating leases. These leases qualify for operating lease accounting treatment under SFAS No. 13, Accounting for Leases, and, as such, these facilities are not included on its Condensed Consolidated Balance Sheets.

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The following is a schedule of operating leases payments (in thousands):

Year Ending December 31,	
2007 (remainder)	$ 760
2008	933
2009	1,027
2010	1,151
2011	1,307
Thereafter	2,970
Future minimum rental payments	$ 8,148

Warranty Obligations.

The Company provides a standard one to two year warranty coverage on its systems. Warranty coverage provided is for labor and parts necessary to repair the systems during the warranty period. The Company accounts for the estimated warranty cost as a charge to costs of revenue, when revenue is recognized. The estimated warranty cost is based on historical product performance and expenses to repair systems. Utilizing actual service records, the Company calculates the average service labor, overhead and parts expense per system and applies those averages to the actual units exposed to future warranty claims. The Company updates these estimates on a quarterly basis.

The following table provides the changes in the product warranty accrual for the three months ended March 31, 2007 and 2006 (in thousands):

	March 31, 2007	March 31, 2006
Balance at December 31, 2006 and 2005	$ 3,055	$ 2,043
Accruals for warranties issued during the period	1,323	1,178
Settlements made during the period	(1,385)	(876)
Balance at March 31, 2007 and 2006	$ 2,993	$ 2,345

Purchase Commitments.

The Company maintains certain open inventory purchase commitments with its suppliers to ensure a smooth and continuous supply for key components. The Company s liability in these purchase commitments is generally restricted to a forecasted time-horizon as mutually agreed upon between the parties. This forecast time-horizon can vary among different suppliers. The Company s open inventory purchase commitments were not material at March 31, 2007.

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

Caution Regarding Forward-Looking Statements

The following discussion should be read in conjunction with the attached financial statements and notes thereto, and with our audited financial statements and notes thereto for the fiscal year ended December 31, 2006 as contained in our annual report on Form 10-K filed with the SEC on March 16, 2007. This quarterly report, including the following sections, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that involve risks and uncertainties. These statements include, but are not limited to, statements relating to our expectations as to growth in our revenue due to the launch of new products, growth of

our operations, success of improved sales productivity, future capital expenditures and requirements and the impact of exchange rate volatility. These forward-looking statements involve risks and uncertainties. The cautionary statements set forth below and those contained in Part II, Item 1A Risk Factors commencing on page [xx], identify important factors that could cause actual results to differ materially from those predicted in any such forward-looking statements. The reader is cautioned not to place undue reliance on these forward-looking statements, which reflect management s analysis and expectations only as of the date of this report. We undertake no obligation to update forward-looking statements to reflect events or circumstances occurring after the date of this Form 10-Q.

Introduction

The Management s Discussion and Analysis, or MD&A, is organized as follows:

Executive summary. This section provides a general description and history of our business, a brief discussion of our product lines and the opportunities, trends, challenges and risks we focus on in the operation of our business.

Critical accounting policies and estimates. This section describes the key accounting policies that are affected by critical accounting estimates.

Recent accounting pronouncements. This section describes the issuance and effect of new accounting pronouncements that may be applicable to us.

Results of operations. This section provides our analysis and outlook for the significant line items on our Consolidated Statements of Operations.

Liquidity and capital resources. This section provides an analysis of our liquidity and cash flows, as well as a discussion of our commitments that existed as of March 31, 2007.

Executive Summary

Company Description. We are a global medical device company engaged in the design, development, manufacture, marketing and servicing of laser and other light-based aesthetics systems to the professional aesthetic market. Our easy-to-use platforms CoolGlide, Xeo and Solera enable dermatologists, plastic surgeons, gynecologists, primary care physicians and other qualified practitioners to perform safe, effective and non-invasive aesthetic procedures for their customers.

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Our corporate headquarters and U.S. operations are located in Brisbane, California, from where we conduct our manufacturing, warehousing, research, regulatory, sales, service, marketing and administrative activities. In the United States, we market, sell and service our products primarily through direct sales and service employees and through a distribution relationship with PSS World Medical Shared Services, Inc., a wholly owned subsidiary of PSS World Medical, or PSS, which has over 700 sales representatives serving physician offices throughout the United States. In addition, we also sell certain items, like Titan handpiece refills and marketing brochures, via the web.

International sales are generally made through a direct sales force and through independent sales representatives and distributors in over 30 countries worldwide. Outside the United States, we have a direct sales presence in Australia, Canada, France, Japan, Spain, Switzerland and the United Kingdom.

Products. Our revenue is derived from the sale of products, product upgrades, service and Titan handpiece refills. Product revenue represents the sale of a system console that incorporates a universal graphic user interface, a laser and/or other light-based module, control system software, high voltage electronics and one or more handpieces. We offer our customers the ability to select the system that best fits their practice at the time of purchase and then to cost-effectively add applications as their practice grows. This enables customers to upgrade their systems whenever they want and provides us with a source of recurring revenue, which we classify as product upgrade revenue. Service revenue relates to amortization of pre-paid service contract revenue and receipts for services on out-of-warranty products. Titan handpiece refill revenue is associated with our Titan handpiece, which requires a periodic refilling process, which includes the replacement of the optical source after a set number of pulses have been performed.

Significant Business Trends. We believe that our revenue growth has been, and will continue to be, primarily attributable to the following:

Investments made in our global sales and marketing infrastructure, including the expansion of our sales force to increase our market penetration in an expanding aesthetic laser market.

Continuing introduction of new aesthetic products and applications.

Marketing to physicians outside the core dermatologist and plastic surgeon specialties.

Generating service and Titan handpiece refill revenue from our growing installed base of customers.

During the three months ended March 31, 2007, compared to the same period in 2006, our U.S. revenue increased by 6% and our international revenue increased by 27%. During the three months ended March 31, 2006, compared to the same period in 2005, our U.S. revenue increased by 44% and our international revenue increased by 23%. The significant decrease in the U.S. revenue growth rate was primarily attributable to lower sales productivity of our junior sales representatives, reduced revenue from our PSS and other national accounts, which contributed to lower productivity for many of our U.S. sales people, and higher than expected turnover of sales representatives that absorbed significant amounts of sales-management time. In an effort to improve our revenue, we have implemented several strategic initiatives, including discontinuing the junior-sales program, planned expansion of our North American direct sales force with more experienced and senior representatives and dedicating additional senior sales representatives to work closely with, and increase the focus and attention on, our PSS relationship.

For the three months ended March 31, 2007, our gross margin declined to 67%, compared to 72% in the same period of 2006. This decrease was primarily attributable to patent royalty expense of $944,000, or 4% of revenue, that was included in our cost of goods sold for the three months ended March 31, 2007 but was not there in the same period in 2006. We resolved our patent litigation settlement in the second quarter of 2006. Given our royalty expense will now continue in the future and we expect our revenue growth rate compared to the prior year to improve in the second half of 2007, we expect our quarterly gross margin to be approximately 66% to 70% for the remainder of the year.

General and administrative expenses for the three months ended March 31, 2007, compared to the same period in 2006, decreased by $1.4 million, or 31%, to $3.0 million and were 13% of net revenue. This decrease was primarily attributable to decreased legal expenses of approximately $1.5 million primarily relating to the patent litigation, which was settled in the second quarter of 2006. In April 2007, there was a securities class action lawsuit filed against us- see Part II, Item 1 Legal Proceedings. However, given we retain director and officer liability insurance, we expect the impact from this litigation to be not material for the remainder of 2007 and therefore expect our G&A expenses to

remain in the range of $3.0 million to $3.5 million per quarter for the remainder of 2007.

Factors that May Impact Future Performance

Our industry is impacted by numerous competitive, regulatory and other significant factors. Our industry is highly competitive and our success depends on our ability to compete successfully. Additionally, the growth of our business relies on our ability to continue to develop new products and innovative technologies, obtain regulatory clearances for our products, protect the proprietary technology of our products and our manufacturing processes, manufacture our products cost effectively, and successfully market and distribute our products in a profitable manner. If we fail to compete effectively, fail to continue to develop new products and technologies, fail to obtain regulatory clearances, fail to protect our intellectual property, fail to produce our products cost effectively, or fail to market and distribute our products in a profitable manner, our business could suffer. A detailed discussion of these and other factors that could impact our future performance are provided in Part II, Item 1A Risk Factors section.

Critical Accounting Policies and Estimates.

The accounting policies that we consider to be critical, subjective, or requiring complex judgments in their application are summarized in *Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations* in our Annual Report on Form 10-K for the year ended December 31, 2006 filed with SEC on March 16, 2007. Other than the adoption of FIN 48, there have been no significant changes during the three months ended March 31, 2007 to the items that we disclosed as our critical accounting policies and estimates in our Annual Report on Form 10-K for the year ended December 31, 2006.

Income Taxes We operate in multiple taxing jurisdictions, both within the United States and outside the United States. We have filed tax returns with positions that may be challenged by the tax authorities. These positions relate to, among others, deductibility of certain expenses, transfer pricing, expenses included in our research and development tax credit computations, as well as other matters. Although the outcome of tax audits is uncertain, in management s opinion, adequate provisions for income taxes have been made for potential liabilities resulting from such matters. We regularly assess the tax positions for such matters and include reserves for those differences in position. The reserves are utilized or reversed once the statute of limitations has expired and/or at the conclusion of the tax examination. We believe that the ultimate outcome of these matters will not have a material impact on our financial position, financial operations or liquidity. Effective January 1, 2007, we adopted FIN 48 (refer to Note 7)

Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities or SFAS No. 159, which permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 also includes an amendment to SFAS No. 115, Accounting for

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Certain Investments in Debt and Equity Securities, which applies to all entities with available-for-sale and trading securities. This statement is required to be adopted in our fiscal year ended December 31, 2008. We are currently assessing the potential impact of implementing this standard on our consolidated financial position, results of operations and cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements,* or SFAS No. 157. This standard defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America, and expands disclosure about fair value measurements. This pronouncement applies under other accounting standards that require or permit fair value measurements. Accordingly, this statement does not require any new fair value measurement. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We will be required to adopt SFAS No. 157 in the quarter ended March 31, 2008 and are currently assessing the impact that this may have on our consolidated financial position, results of operations and cash flows.

Results of Operations

The following table sets forth selected consolidated financial data for the periods indicated, expressed as a percentage of net revenue.

	Three Months Ended March 31,	
	2007	**2006**
Operating Ratio:		
Net revenue	100%	100%
Cost of revenue	33%	28%
Gross margin	67%	72%
Operating expenses:		
Sales and marketing	39%	41%
Research and development	8%	6%
General and administrative	13%	21%
Total operating expenses	60%	68%
Income from operations	7%	3%
Interest and other income, net	4%	5%
Income before income taxes	11%	8%
Provision for income taxes	3 %	3 %
Net income	8%	5%

Total Revenue

	Three Months Ended March 31,		
(Dollars in thousands)	**2007**	**% Change**	**2006**
Revenue mix by geography:			
United States	$ 15,845	6%	$ 14,908
International	7,412	27%	5,849
Consolidated total revenue	$ 23,257	12%	$ 20,757

United States as a percentage of total revenue	68%		72%
International as a percentage of total revenue	32%		28%
Revenue mix by product category:			
Products	$ 18,316	4%	$ 17,556
Product upgrades	1,922	69%	1,136
Service	1,917	71%	1,121
Titan handpiece refills	1,102	17%	944
Consolidated total revenue	$ 23,257	12%	$ 20,757

During the three months ended March 31, 2007, compared to the same period in 2006, our U.S. revenue increased by 6% and our international revenue increased by 27%. During the three months ended March 31, 2006, compared to the same period in 2005, our U.S. revenue increased by 44% and our international revenue increased by 23%. The improved international revenue growth in 2007 was primarily attributable to strong revenue growth from Canada, Australia and many European countries. From a product category perspective, we experienced significant revenue growth in product upgrades primarily due to customers upgrading from our CoolGlide platform to our multi-application Xeo platform and additional ProWave and Limelight handpiece upgrades. In addition, our service revenue continued to grow as a result of an increase in our installed base of customers purchasing extended service contracts. Growth in Titan handpiece refills reflected increased adoption of the Titan product by new and existing customers as well as an increased consumer demand for Titan procedures.

The significant decrease in the U.S. revenue growth rate to 6% in the first quarter of 2007, compared with a growth rate of 44% in the first quarter of 2006, was primarily attributable to reduced sales productivity of our junior sales representatives, sales employee turnover and reduced revenue from our national accounts. We have implemented initiatives to improve the productivity of our sales force and plan to expand our direct sales headcount in the remainder of 2007. Due to these factors, and the expected shipments of our new application- Pearl- starting from the second quarter of 2007, we expect our revenue growth rates to be favorably impacted in the second half of 2007, compared with the first half of 2007.

Gross Margin

	Three Months Ended March 31,		
(Dollars in thousands)	**2007**	**% Change**	**2006**
Gross margin	$ 15,476	4%	$ 14,946
As a percentage of total revenue	*67%*		*72%*

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Our cost of revenue consists primarily of material, labor, stock-based compensation, royalty expense, warranty, and manufacturing overhead expenses. The decrease in gross margin in the first quarter of 2007 to 67%, compared to 72% in the same period of 2006, was primarily attributable to patent royalty expense of $944,000, or 4% of revenue, that was included in our cost of revenue for the three months ended March 31, 2007 but was not there in the same period in 2006. We resolved our patent litigation settlement in the second quarter of 2006. Given our royalty expense will now continue in the future and we expect our revenue growth rate compared to the prior year to improve in the second half of 2007, we expect our quarterly gross margin to be approximately 66% to 70% for the remainder of the year.

Sales and Marketing

	Three Months Ended March 31,		
(Dollars in thousands)	**2007**	**% Change**	**2006**
Sales and marketing	$ 9,063	6%	$ 8,546
As a percentage of total revenue	*39%*		*41%*

Sales and marketing expenses consist primarily of labor, stock-based compensation, expenses associated with customer-attended workshops and trade shows, and advertising. The increase in sales and marketing expenses in the three months ended March 31, 2007, compared to the same period in 2006, was primarily attributable to $524,000 of higher personnel related expenses. The decrease in our sales and marketing expenses as a percentage of revenue in the quarter ended March 31, 2007, was primarily attributable to revenue increasing at a faster pace than our expenses. Due to the planned increase of our direct sales employees in the U.S., we expect our sales and marketing expenses to increase from their current levels for the remainder of 2007. However, with the expected increase in our revenue in the second half of 2007, we expect our sales and marketing expenses to decrease as a percentage of revenue in that period.

Research and Development (R&D)

	Three Months Ended March 31,		
(Dollars in thousands)	**2007**	**% Change**	**2006**
Research and development	$ 1,747	34%	$ 1,307
As a percentage of total revenue	*8%*		*6%*

Research and development expenses consist primarily of labor, stock-based compensation, clinical, regulatory and material costs. In the three months ended March 31, 2007, R&D expenses increased by $440,000 to 8% of total revenue, compared with 6% in the same period in 2006. This increase was primarily attributable to $153,000 of higher material costs, $112,000 of higher personnel expenses and $100,000 of higher outside services related to clinical studies and consulting expenses. For the remainder of 2007, as we continue to invest in our R&D efforts and perform clinical studies to gather additional data relating to our Pearl application, we expect our R&D expenses to increase from their current levels for the remainder of 2007. However, with the expected increase in our revenue in the second half of 2007, we expect our R&D expenses to decrease as a percentage of revenue in that period.

General and Administrative (G&A)

	Three Months Ended March 31,		
(Dollars in thousands)	**2007**	**% Change**	**2006**
General and administrative	$ 3,018	-31 %	$ 4,375
As a percentage of total revenue	*13%*		*21%*

General and administrative expenses consist primarily of labor, stock-based compensation, legal fees, accounting, audit and tax consulting fees, and other general and administrative expenses. G&A expenses for the three months ended March 31, 2007, compared to the same period in 2006, decreased by $1.4 million, or 31%, to $3.0 million and were 13% of net revenue. This decrease was primarily attributable to decreased legal expenses of approximately $1.5 million primarily relating to the patent litigation, which was settled in the second quarter of 2006. In April 2007, there was a securities class action lawsuit filed against us- see Part II, Item 1 Legal Proceedings. However, given we retain director and officer liability insurance, we expect the impact from this litigation to be not material for the remainder of 2007 and therefore expect our G&A expenses to remain in the range of $3.0 million to $3.5 million, per quarter, for the remainder of 2007.

Interest and Other Income, Net

(Dollars in thousands)	Three Months Ended March 31, 2007	% Change	2006
Interest and other income, net	$ *1,002*	*5%*	$ *956*

The increase in interest and other income, net, in the three months ended March 31, 2007, compared to the same period in 2006, was primarily attributable to improved tax-exempt interest yields on investments and an increased amount invested. Our cash, cash equivalents and marketable investment balances was at $111.2 million as of March 31, 2007 compared with $95.5 million as of March 31, 2006.

Provision for Income Taxes

(Dollars in thousands)	Three Months Ended March 31, 2007	Change	2006
Income before income taxes	$ 2,650	$ 976	$ 1,674
Provision (benefit) for income taxes	895	328	567
Effective tax rate	*34%*		*34%*

Our effective tax rate reflects applicable United States federal and state tax rates and the tax impact of foreign operations, offset primarily by research and development tax credits (in the three months ended March 31, 2007 only) and tax exempt interest income.

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Liquidity and Capital Resources

Liquidity is the measurement of our ability to meet potential cash requirements, fund the planned expansion of our operations and acquire businesses. Our sources of cash include operations, marketable investments, stock option exercises and employee stock purchases. We actively manage our cash usage and investment of liquid cash to ensure the maintenance of sufficient funds to meet our daily needs.

Cash, Cash Equivalents and Marketable Investments

The following table summarizes our cash, cash equivalents and marketable securities (in thousands):

	March 31, 2007	December 31, 2006	Increase/ (Decrease)
Cash and cash equivalents	$ 16,876	$ 11,800	$ 5,076
Marketable investments	94,363	96,285	$ (1,922)
Total	$ 111,239	$ 108,085	$ 3,154

The net increase in cash, cash equivalents and marketable investments of $3.2 million in the three months ended March 31, 2007, was primarily a result of $2.2 million of cash provided by the issuance of common stock related to stock option exercises and employee stock purchases, and $1.1 million of cash generated by operations. As of March 31, 2007, we had cash, cash equivalents and marketable investments of $111.2 million, which we believe are sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months.

Cash Flows

(Dollars in thousands)	Three Months Ended March 31, 2007	2006
Net cash flow provided by (used in):		
Operating activities	$ 1,063	$ 2,112
Investing activities	1,574	(5,976)
Financing activities	2,439	1,555
Net increase (decrease) in cash and cash equivalents	$ 5,076	$ (2,309)

Net Cash Provided by Operating Activities

We generated net cash from operating activities of $1.1 million in the three months ended March 31, 2007, compared to $2.1 million for the same period in 2006. For the three months ended March 31, 2007, $3.8 million was generated by net income after adjusting for non-cash related items (primarily $1.3 million of stock-based compensation and $710,000 of tax benefit from stock option exercises), which was offset by $2.8 million of net cash used to decrease our net operating assets and liabilities (primarily $1.3 million decrease due to an increase in inventories and a $1.6 million decrease due to a reduction in accrued liabilities from the higher December 31, 2006 year-end balances that resulted from the strong fourth quarter 2006 operations).

For the three months ended March 31, 2006, the net cash provided by operations was $2.1 million. This was primarily attributable to $2.5 million of net income after adjusting for non-cash related items (primarily $1.1 million of stock-based compensation, $1.0 million of tax benefit from stock option exercises, reduced by $1.0 million of excess tax benefits reclassed to financing activities). This was offset by $392,000 net cash used to decrease our net operating assets and liabilities (primarily $1.4 million cash used to increase inventories offset by $1.0 million of cash provided by an increase in accounts payable).

Net Cash Provided by / Used in Investing Activities

We generated $1.6 million of cash from investing activities for the three months ended March 31, 2007 primarily attributable to $1.9 million net proceeds from the sales and maturities of marketable investments, which was partially offset by $341,000 used to purchase property and equipment for primarily marketing and R&D functions.

For the three months ended March 31, 2006, we used $6.0 million, net, for primarily investing in tax-exempt marketable investments.

Net Cash Provided by Financing Activities

Net cash provided by financing activities in the three months ended March 31, 2007 and the same period in 2006, was $2.4 million and $1.6 million, respectively. This was primarily attributable to the proceeds from the issuance of stock through our stock option and employee stock purchase plans and the excess tax benefits from the sale of these options.

Contractual Cash Obligations

The following summarizes our contractual obligations as of March 31, 2007 for minimum lease payments related to facility leases in California, Japan, Switzerland and France.

		Payments Due by Period ($ 000 s)			
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Operating leases	$ 8,148	$ 1,020	$ 1,989	$ 2,525	$ 2,614

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to interest rate risk relates primarily to our investment portfolio. Fixed rate securities may have their fair market value adversely impacted due to fluctuations in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectation due to changes in interest rates or we may suffer losses in principal if forced to sell securities which have declined in market value due to changes in interest rates. The primary objective of our investment activities is to preserve principal while at the same time maximizing yields

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without significantly increasing risk. To achieve this objective, we invest in debt instruments of the U.S. Government and its agencies, municipal bonds and high-quality corporate issuers, and, by policy, restrict our exposure to any single corporate issuer by imposing concentration limits. To minimize the exposure due to adverse shifts in interest rates, we maintain investments at a weighted average maturity (interest reset date for auction-rate securities and variable rate demand notes) of generally less than eighteen months. Assuming a hypothetical increase in interest rates of one percentage point, the fair value of our total investment portfolio as of March 31, 2007 would have potentially declined by $727,000.

We have international subsidiaries and operations and are, therefore, subject to foreign currency rate exposure. To date, our exposure to exchange rate volatility has not been significant. We cannot assure that there will not be a material impact in the future. Although the majority of our sales and purchases are denominated in U.S. dollars, future fluctuations in the value of the U.S. dollar may affect the price competitiveness of our products. We do not believe, however, that we currently have significant direct foreign currency exchange rate risk and have not hedged exposures denominated in foreign currencies.

We do not utilize derivative financial instruments, derivative commodity instruments or other market risk sensitive instruments, positions or transactions in any material fashion.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Attached as exhibits to this Quarterly Report are certifications of the Company s Chief Executive Officer (CEO) and Chief Financial Officer (CFO), which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (Exchange Act). This Controls and Procedures section includes the information concerning the controls evaluation referred to in the certifications, and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

The Company conducted an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures (as defined in the Rules 13a-15(e) and 15d-15(e) under the Exchange Act) (Disclosure Controls) as of the end of the period covered by this Report required by Exchange Act Rules 13a-15(b) or 15d-15(b). The controls evaluation was conducted under the supervision and with the participation of the Company s management, including the CEO and CFO. Based on this evaluation, the CEO and our CFO have concluded that as of the end of the period covered by this report the Company s disclosure controls and procedures were effective at a reasonable assurance level.

Definition of Disclosure Controls

Disclosure Controls are controls and procedures designed to reasonably assure that information required to be disclosed in the Company s reports filed under the Exchange Act, such as this Report, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. Disclosure Controls are also designed to reasonably assure that such information is accumulated and communicated to the Company s management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. The Company s Disclosure Controls include components of its internal control over financial reporting, which consists of control processes designed to provide reasonable assurance regarding the reliability of its financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles in the U.S. To the extent that components of the Company s internal control over financial reporting are included within its Disclosure Controls, they are included in the scope of the Company s annual controls evaluation.

Limitations on the Effectiveness of Controls

The Company s management, including the CEO and CFO, does not expect that the Company s disclosure controls or internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Changes in Internal Control over Financial Reporting

There were no changes in the Company s internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We received notice that a purported securities class action lawsuit was filed on April 17, 2007 against us and two of our officers in the U.S. District Court for the Northern District of California. The plaintiff claims to represent purchasers of our common stock from January 31, 2007 through April 4, 2007. The complaint generally alleges that materially false statements were made regarding our financial prospects, and seeks unspecified monetary damages. We intend to defend this case vigorously. Since the outcome of the litigation is unpredictable, and since we believe that a significant adverse result for us is not probable, no expense has been recorded with respect to the contingent liability associated with this matter. We retain director and officer liability insurance but there is no assurance that such insurance will cover the claims that are made or will insure us fully for all losses on covered claims.

ITEM 1A. RISK FACTORS

Our first quarter 2007 revenue growth and earnings were below the earlier guidance provided to the investor community on January 31, 2007. The initiatives that we are implementing in an effort to improve our revenue and income could be unsuccessful, and the instability we may experience while attempting to improve sales productivity could harm our business and may further depress the price of our stock.

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During the three months ended March 31, 2007, compared to the same period in 2006, our U.S. revenue increased by 6% and during the three months ended March 31, 2006, compared to the same period in 2005, our U.S. revenue increased by 44%. This significant decrease in the U.S. revenue growth rate was primarily attributable to:

- Reduced sales productivity of our junior sales representatives.
- Reduced revenue from PSS and other national accounts. This contributed to lower productivity for many of our U.S. sales people.
- Higher than expected turnover of sales representatives that absorbed significant amounts of sales-management time.

In an effort to improve our revenue and income levels, we have implemented several strategic initiatives, including:

- The junior-sales program has been discontinued.
- We have dedicated additional senior sales representatives to work closely with, and increase the focus and attention on, our PSS relationship.
- We plan to expand our North American direct sales force with more experienced and senior representatives.

We believe these initiatives should improve our revenue and income. However, these initiatives may not be successful. The reorganization may lead to employee turnover. There are no assurances that we can adequately hire and train new sales employees. The instability we may experience while attempting to improve sales productivity could harm our business. Each of these factors could harm our business and may cause a further decline in our stock price.

There was a purported securities class action lawsuit filed against us in April 2007 due to a substantial decrease in our stock price following the announcement of our preliminary first quarter 2007 revenue and earnings per share data which was below our earlier guidance. Defending ourselves against this class action lawsuit could distract management and harm our business.

On April 5, 2007, our stock price declined by approximately 31% following the announcement of our preliminary revenue and net income per share information, which was lower than the guidance we had given on January 31, 2007. A purported securities class action lawsuit was filed against us in response to that decline in our stock price. We will incur legal costs as a result of this securities litigation. We retain director and officer liability insurance but there can be no guarantee that such insurance will cover the claims that are made or will insure us fully for all losses on covered claims. This litigation may distract our management and consume resources that would otherwise have been directed toward running our business. Each of these factors could harm our business.

We compete against companies that have longer operating histories, more established products and greater resources, which may prevent us from achieving significant market penetration or increased operating results.

Our products compete against similar products offered by public companies, such as Candela, Cynosure, Elen (in Italy), Iridex, Palomar, Syneron and Thermage, as well as private companies such as Alma, Aesthera, Lumenis, Reliant Technologies, Sciton and several other smaller companies. Competition with these companies could result in price-cutting, reduced profit margins and loss of market share, any of which would harm our business, financial condition and results of operations. We also face competition from medical products, such as Botox, an injectable compound used to reduce wrinkles, and collagen injections. Other alternatives to the use of our products include sclerotherapy, a procedure involving the injection of a solution into the vein to collapse it, electrolysis, a procedure involving the application of electric current to eliminate hair follicles, and chemical peels. We may also face competition from manufacturers of pharmaceutical and other products that have not yet been developed. Our ability to compete effectively depends upon our ability to distinguish our company and our products from our competitors and their products, and includes such factors as:

intellectual property protection;

product performance;

product pricing;

quality of customer support;

success and timing of new product development and introductions; and

development of successful distribution channels, both domestically and internationally.

Some of our competitors have more established products and customer relationships than we do, which could inhibit our market penetration efforts. For example, we have encountered, and expect to continue to encounter, situations where, due to pre-existing relationships, potential customers decided to purchase additional products from our competitors. Potential customers also may need to recoup the cost of expensive products that they have already purchased from our competitors and may decide not to purchase our products, or to delay such purchases. If we are unable to achieve continued market penetration, we will be unable to compete effectively and our business will be harmed.

In addition, some of our current and potential competitors have significantly greater financial, research and development, business development, manufacturing, and sales and marketing resources than we have. Our competitors could utilize their greater financial resources to acquire other companies to gain enhanced name recognition and market share, as well as new technologies or products that could effectively compete with our existing product lines. Our competitors could form strategic alliances with other companies to develop products and solutions that effectively compete with our products. For example, Palomar and Syneron have each entered into agreements with Proctor and Gamble for the proposed development of home-use aesthetic devices. And Syneron entered into an agreement with Obagi Medical Products to study the effects of using Obagi s skin care products during treatments with Syneron aesthetic devices. Business combinations and alliances by our competitors could increase competition, which could harm our business.

Competition among providers of laser and other energy-based devices for the aesthetic market is characterized by rapid innovation, and we must continuously develop new products or our revenue may decline.

While we attempt to protect our products through patents and other intellectual property, there are few barriers to entry that would prevent new entrants or existing competitors from developing products that compete directly with ours. For example, while our CoolGlide product was the first long-pulse Nd:YAG, or long

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wavelength, laser system cleared by the FDA for permanent hair reduction on all skin types, competitors have subsequently introduced systems that utilize Nd:YAG lasers, and received FDA clearances to market these products as treating all skin types. We expect that any competitive advantage we may enjoy from other current and future innovations, such as combining multiple handpieces in a single system to perform a variety of applications, may diminish over time, as companies successfully respond to our, or create their own, innovations. Consequently, we believe that we will have to continuously innovate and improve our products and technology to compete successfully. If we are unable to innovate successfully, our products could become obsolete and our revenue will decline as our potential customers base purchases our competitors products.

Our ability to compete depends upon our ability to innovate, to develop and commercialize new products and product enhancements, and to identify new markets for our technology.

We have created products to apply our technology to hair removal, treatment of veins, skin rejuvenation, treatment of pigmented lesions and treatment of wrinkles. Currently, these applications represent the majority of laser and other energy-based aesthetic procedures. To be successful in the future, we must develop new and innovative aesthetic applications, identify new markets for our existing technology, and develop new technology from various platforms. To successfully expand our product offerings, we must:

- develop or acquire new products that either add to or significantly improve our current products;
- convince our target customers that our new products or product upgrades would be an attractive revenue-generating addition to their practices;
- sell our products to a broad customer base;
- identify new markets and alternative applications for our technology;
- protect our existing and future products with defensible intellectual property; and
- satisfy and maintain all regulatory requirements for commercialization.

Every year since 2000, we have introduced at least one new product. Historically, these introductions have been a significant component of our financial performance. Our business strategy is based, in part, on our expectation that we will continue to make annual product introductions that we can sell to new customers and to existing customers as upgrades. For the three months ended March 31, 2007, we invested $1.7 million or 8% of net revenue, in our research and development department. Even with a significant investment in research and development, we may be unable, however, to continue to develop new products and technologies annually, or at all, which could adversely affect our projected growth rate.

If there is not sufficient demand for the procedures performed with our products, practitioner demand for our products could be inhibited, resulting in unfavorable operating results and reduced growth potential.

Continued expansion of the global market for laser- and other energy-based aesthetic procedures is a material assumption of our growth strategy. Most procedures performed using our products are elective procedures not reimbursable through government or private health insurance, with the costs borne by the patient. The decision to utilize our products may therefore be influenced by a number of factors, including:

- the cost of procedures performed using our products;

the cost, safety and effectiveness of alternative treatments, including treatments which are not based upon laser- or other energy-based technologies and treatments which use pharmaceutical products;

the success of our sales and marketing efforts; and

consumer confidence, which may be impacted by economic and political conditions.

If, as a result of these factors, there is not sufficient demand for the procedures performed with our products, practitioner demand for our products could be reduced, resulting in unfavorable operating results and lower growth potential.

If PSS World Medical fails to perform to our expectations, we may fail to achieve anticipated operating results.

We have a distribution agreement with PSS World Medical Shared Services, Inc., or PSS, a wholly-owned subsidiary of PSS World Medical. PSS sales representatives work in coordination with our sales force to locate new potential customers for our products throughout the United States. For the year ended December 31, 2006, approximately 15% of our revenue came from PSS. For the quarter ended March 31, 2007, revenue from PSS transactions was below what we had anticipated. We have dedicated additional senior sales representatives to work closely with, and increase the focus and attention on, our PSS relationship.

We can provide no guarantee that the increased focus on PSS will translate into increased revenue from them. Further, if PSS does not perform adequately under the arrangement, or terminates our relationship, it may have a material adverse effect on our business, financial condition, results of operations or future cash flows.

If our public guidance or our future operating performance does not meet investor expectations, our stock price could decline.

We provide guidance to the investing community regarding our anticipated future operating performance, both for the coming quarters and fiscal year. Our business typically has a short sales cycle, we do not have significant backlog of orders at the start of a quarter, and our ability to sell our products successfully is subject to many uncertainties, as discussed herein. In light of those factors, it is difficult for us to estimate with accuracy our future results. In the past, our actual performance had turned out to be significantly different from our prior guidance. For example, in January 2007, we indicated that we expected revenue for the first quarter of 2007 to be $26 million. Actual revenue for that quarter was $23.3 million. Upon our announcement in April 2007 of that news, our stock price declined by 31%. If in the future our actual results do not meet our public guidance, or our results or guidance as to the future were to be below the expectations of third party financial analysts, our stock price could again decline significantly.

The price of our common stock may fluctuate substantially.

The public market price of our common stock has in the past fluctuated substantially and may continue to do so in the future. As stated above, our stock price declined by 31% on April 5, 2007, when we announced that our preliminary first quarter 2007 revenue and earnings per share will not meet our earlier guidance provided to the investor community. The market price for our common stock will be affected by a number of factors, including:

quarterly variations in our, or our competitors, results of operations;

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changes in earnings estimates or guidance, investors perceptions, recommendations by securities analysts or our failure to achieve analysts earning estimates;

the announcement of new products or service enhancements by us or our competitors;

the announcement of the departure of a key employee or executive officer;

regulatory developments or delays concerning our, or our competitors , products;

the initiation of litigation by us or one of our competitors; and

general market conditions and other factors unrelated to our operating performance or the operating performance of our competitors.

Actual or perceived instability in our stock price could reduce demand from potential buyers of our stock, thereby causing our stock price to decline.

We may be involved in future costly intellectual property litigation, which could impact our future business and financial performance.

Our competitors or other patent holders may assert that our present or future planned products and the methods we employ are covered by their patents. In addition, we do not know whether our competitors will apply for and obtain patents that will prevent, limit or interfere with our ability to make, use, sell or import our products. Although we may seek to resolve any potential future claims or actions, we may not be able to do so on reasonable terms, or at all. If, following a successful third-party action for infringement, we cannot obtain a license or redesign our products, we may have to stop manufacturing and marketing our products and our business would suffer as a result.

We may become involved in litigation not only as a result of alleged infringement of a third party s intellectual property rights but also to protect our own intellectual property. For example, we have been, and may hereafter become, involved in litigation to protect the trademark rights associated with our company name or the names of our products. Infringement and other intellectual property claims, with or without merit, can be expensive and time-consuming to litigate, and could divert management s attention from our core business. We do not know whether necessary licenses would be available to us on satisfactory terms, or whether we could redesign our products or processes to avoid infringement. If we lose this kind of litigation, a court could require us to pay substantial damages, and prohibit us from using technologies essential to our products, any of which would have a material adverse effect on our business, results of operations and financial condition.

Intellectual property rights may not provide adequate protection for some or all of our products, which may permit third parties to compete against us more effectively.

We rely on patent, copyright, trade secret and trademark laws and confidentiality agreements to protect our technology and products. At March 31, 2007, we had seven issued U.S. patents. Some of our other components, such as our laser module, electronic control system and high-voltage electronics, are not, and in the future may not be, protected by patents. Additionally, our patent applications may not issue as patents or, if issued, may not issue in a form that will be advantageous to us. Any patents we obtain may be challenged, invalidated or legally circumvented by third parties. Consequently, competitors could market products and use manufacturing processes that are substantially similar to, or superior to, ours. We may not be able to prevent the unauthorized disclosure or use of our technical knowledge or other trade secrets by consultants, vendors, former employees or current employees, despite the existence generally of confidentiality agreements and other contractual restrictions. Monitoring unauthorized uses and disclosures of our intellectual property is difficult, and we do not know whether the steps we have taken to protect our intellectual property will be effective. Moreover, the laws of many foreign countries will not protect our intellectual property rights to the same extent as the laws of the United States.

The absence of complete intellectual property protection exposes us to a greater risk of direct competition. Competitors could purchase one of our products and attempt to replicate some or all of the competitive advantages we derive from our development efforts, design around our protected technology, or develop their own competitive technologies that fall outside of our intellectual property rights. If our intellectual property is not adequately protected against competitors products and methods, our competitive position could be adversely affected, as could our business.

If we fail to obtain clearance from the U.S. Food and Drug Administration to market our Titan product for additional indications, our revenue from this product may be adversely affected.

Our Titan product, introduced in 2004, is a material component of our growth strategy. We currently have FDA clearance to market Titan in the United States for deep dermal heating. The FDA has denied our initial 510(k) application to market Titan for wrinkle reduction on the basis that Titan is not substantially equivalent to predicate devices for the treatment of wrinkles. We cannot promote or advertise our Titan product in the United States for any indications other than deep dermal heating until we receive additional FDA clearances, but there are no assurances as to when, or whether, we will ever obtain such clearances. In the event that we do not obtain additional FDA clearances, our ability to market Titan in the United States and revenue derived therefrom, including revenue from both Titan unit sales and handpiece refills, may be adversely affected.

If we fail to obtain or maintain necessary FDA clearances for our products and indications, if clearances for future products and indications are delayed or not issued, or if there are federal or state level regulatory changes, our commercial operations would be harmed.

Our products are medical devices that are subject to extensive regulation in the United States by the FDA for manufacturing, labeling, sale, promotion, distribution and shipping. Before a new medical device, or a new use of or labeling claim for an existing product, can be marketed in the United States, it must first receive either 510(k) clearance or pre-marketing approval from the FDA, unless an exemption applies. Either process can be expensive and lengthy. In the event that we do not obtain FDA clearances or approvals for our products, our ability to market and sell them in the United States and revenue derived therefrom may be adversely affected.

Medical devices may be marketed only for the indications for which they are approved or cleared and if we are found to be marketing our products for off-label, or non-approved, uses we might be subject to FDA enforcement action or have other resulting liability. We have obtained 510(k) clearance for the indications for which we market our products. However, our clearances can be revoked if safety or effectiveness problems develop. We also are subject to Medical Device Reporting regulations, which require us to report to the FDA if our products cause or contribute to a death or serious injury, or malfunction in a way that would likely cause or contribute to a death or serious injury. Our products are also subject to state regulations, which are, in many instances, in flux. Changes in state regulations may impede sales. For example, federal regulations allow our products to be sold to, or on the order of, licensed practitioners, as determined on a state-by-state basis. As a result, in some states, non-physicians may legally purchase our products. However, a state could change its regulations at any time, thereby disallowing sales to particular types of end users. We cannot predict the impact or effect of future legislation or regulations at the federal or state levels.

The FDA and state authorities have broad enforcement powers. Our failure to comply with applicable regulatory requirements could result in enforcement action by the FDA or state agencies, which may include any of the following sanctions:

warning letters, fines, injunctions, consent decrees and civil penalties;

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repair, replacement, recall or seizure of our products;

operating restrictions or partial suspension or total shutdown of production;

refusing our requests for 510(k) clearance or pre-market approval of new products, new intended uses, or modifications to existing products;

withdrawing 510(k) clearance or pre-market approvals that have already been granted; and

criminal prosecution.

If any of these events were to occur, they could harm our business.

If we fail to comply with the FDA s Quality System Regulation and laser performance standards, our manufacturing operations could be halted, and our business would suffer.

We are currently required to demonstrate and maintain compliance with the FDA s Quality System Regulation, or QSR. The QSR is a complex regulatory scheme that covers the methods and documentation of the design, testing, control, manufacturing, labeling, quality assurance, packaging, storage and shipping of our products. Because our products involve the use of lasers, our products also are covered by a performance standard for lasers set forth in FDA regulations. The laser performance standard imposes specific record-keeping, reporting, product testing and product labeling requirements. These requirements include affixing warning labels to laser products, as well as incorporating certain safety features in the design of laser products. The FDA enforces the QSR and laser performance standards through periodic unannounced inspections. Our failure to take satisfactory corrective action in response to an adverse QSR inspection or our failure to comply with applicable laser performance standards could result in enforcement actions, including a public warning letter, a shutdown of our manufacturing operations, a recall of our products, civil or criminal penalties, or other sanctions, such as those described in the preceding paragraph, which would cause our sales and business to suffer.

If we modify one of our FDA-approved devices, we may need to seek re-approval, which, if not granted, would prevent us from selling our modified products or cause us to redesign our products.

Any modifications to an FDA-cleared device that would significantly affect its safety or effectiveness or that would constitute a major change in its intended use would require a new 510(k) clearance or possibly a pre-market approval. We may not be able to obtain additional 510(k) clearance or pre-market approvals for new products or for modifications to, or additional indications for, our existing products in a timely fashion, or at all. Delays in obtaining future clearance would adversely affect our ability to introduce new or enhanced products in a timely manner, which in turn would harm our revenue and future profitability. We have made modifications to our devices in the past and may make additional modifications in the future that we believe do not or will not require additional clearance or approvals. If the FDA disagrees, and requires new clearances or approvals for the modifications, we may be required to recall and to stop marketing the modified devices, which could harm our operating results and require us to redesign our products.

We may be unable to obtain or maintain international regulatory qualifications or approvals for our current or future products and indications, which could harm our business.

Sales of our products outside the United States are subject to foreign regulatory requirements that vary widely from country to country. In addition, exports of medical devices from the United States are regulated by the FDA. Complying with international regulatory requirements can be an expensive and time-consuming process and approval is not certain. The time required to obtain clearance or approvals, if required by other countries, may be longer than that required for FDA clearance or approvals, and requirements for such clearances or approvals may significantly differ from FDA requirements. We may be unable to obtain or maintain regulatory qualifications, clearances or approvals in other countries. We may also incur significant costs in attempting to obtain and in maintaining foreign regulatory approvals or qualifications. If we experience delays in receiving necessary qualifications, clearances or approvals to market our products outside the United States, or if we fail to receive those qualifications, clearances or approvals, we may be unable to market our products or enhancements in international markets effectively, or at all, which could have a material adverse effect on our business and growth strategy.

To successfully market and sell our products internationally, we must address many issues with which we have little or no experience.

For the three months ended March 31, 2007, approximately 32% of our revenue was derived from international customers, which are a material component of our growth strategy. We depend on third-party distributors and a relatively new direct sales operation to sell our products internationally, and if these distributors or direct sales personnel under-perform, we may be unable to increase or maintain our level of international revenue. We will need to expand the territories in which we sell our products and attract additional international distributors to grow our business. Distributors may not accept our business or commit the necessary resources to market and sell our products to the level of our expectations. If current or future distributors do not perform adequately, or we are unable to engage distributors in particular geographic areas, we may not realize projected international revenue growth. Additionally, we expect to expand our direct sales force in Europe and Asia. If we are unable to hire, retain and obtain satisfactory performance from such additional personnel, our revenue from international operations may be adversely affected.

We believe that an increasing amount of our future revenue will come from international sales as we expand our overseas operations and develop opportunities in additional international territories. International sales are subject to a number of risks, including:

- difficulties in staffing and managing our foreign operations;
- difficulties in penetrating markets in which our competitors products are more established;
- reduced protection for intellectual property rights in some countries;
- export restrictions, trade regulations and foreign tax laws;
- fluctuating foreign currency exchange rates;
- foreign certification and regulatory requirements;
- lengthy payment cycles and difficulty in collecting accounts receivable;
- customs clearance and shipping delays;
- political and economic instability;
- lack of awareness of our brand in international markets; and
- preference for locally-produced products.

If one or more of these risks were realized, it could require us to dedicate significant resources to remedy the situation, and if we are unsuccessful at finding a solution, our revenue may decline.

The expense and potential unavailability of insurance coverage for our customers could adversely affect our ability to sell our products, and therefore our financial condition.

Some of our customers and prospective customers have had difficulty in procuring or maintaining liability insurance to cover their operation and use of our products. Medical malpractice carriers are withdrawing coverage in certain states or substantially increasing premiums. If this trend

continues or worsens, our customers may

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discontinue using our products and, industry-wide, potential customers may opt against purchasing laser and other energy-based products due to the cost of, or inability to, procure insurance coverage. The unavailability of insurance coverage for our customers could adversely affect our ability to sell our products, and therefore our financial condition.

Because we do not require training for users of our products in North America, and we sell our products to non-physicians, there exists an increased potential for misuse of our products, which could harm our reputation and our business.

Federal regulations allow us to sell our products to or on the order of licensed practitioners. The definition of licensed practitioners varies from state to state. As a result, our products may be purchased or operated by physicians with varying levels of training, and in many states by non-physicians, including nurse practitioners, chiropractors and technicians. Outside the United States, many jurisdictions do not require specific qualifications or training for purchasers or operators of our products. We do not supervise the procedures performed with our products, nor do we require that direct medical supervision occur. We, and our distributors, generally offer but do not require purchasers or operators of our products to attend training sessions. In addition, we sometimes sell our systems to companies that rent our systems to third parties and that provide a technician to perform the procedures. The lack of training and the purchase and use of our products by non-physicians may result in product misuse and adverse treatment outcomes, which could harm our reputation and expose us to costly product liability litigation.

Product liability suits could be brought against us due to a defective design, material or workmanship or misuse of our products and could result in expensive and time-consuming litigation, payment of substantial damages and an increase in our insurance rates.

If our products are defectively designed, manufactured or labeled, contain defective components or are misused, we may become subject to substantial and costly litigation by our customers or their patients. Misusing our products or failing to adhere to operating guidelines could cause significant eye and skin damage, and underlying tissue damage. In addition, if our operating guidelines are found to be inadequate, we may be subject to liability. We have been involved, and may in the future be involved, in litigation related to the use of our products. Product liability claims could divert management s attention from our core business, be expensive to defend and result in sizable damage awards against us. We may not have sufficient insurance coverage for all future claims. We may not be able to obtain insurance in amounts or scope sufficient to provide us with adequate coverage against all potential liabilities. Any product liability claims brought against us, with or without merit, could increase our product liability insurance rates or prevent us from securing continuing coverage, could harm our reputation in the industry and reduce product sales. In addition, we have been experiencing steep increases in our product liability insurance premiums. If our premiums continue to rise, we may no longer be able to afford adequate insurance coverage.

If we are unable to maintain adequate insurance coverage, or we have product liability claims in excess of our insurance coverage, claims would be paid out of cash reserves, thereby harming our financial condition, operating results and profitability.

Our manufacturing operations are dependent upon third-party suppliers, making us vulnerable to supply shortages and price fluctuations, which could harm our business.

Many of the components and materials that comprise our products are currently manufactured by a limited number of suppliers. A supply interruption or an increase in demand beyond our current suppliers capabilities could harm our ability to manufacture our products until a new source of supply is identified and qualified. Our reliance on these suppliers subjects us to a number of risks that could harm our business, including:

- interruption of supply resulting from modifications to or discontinuation of a supplier s operations;
- delays in product shipments resulting from uncorrected defects, reliability issues or a supplier s variation in a component;
- a lack of long-term supply arrangements for key components with our suppliers;
- inability to obtain adequate supply in a timely manner, or on commercially reasonable terms;

difficulty locating and qualifying alternative suppliers for our components in a timely manner;

production delays related to the evaluation and testing of products from alternative suppliers, and corresponding regulatory qualifications;

delay in delivery due to our suppliers prioritizing other customer orders over ours; and

Fluctuation in delivery by our suppliers due to changes in demand from us or their other customers.

Any interruption in the supply of components or materials, or our inability to obtain substitute components or materials from alternate sources at acceptable prices in a timely manner, could impair our ability to meet the demand of our customers, which would have an adverse effect on our business.

Components used in our products are complex in design, and any defects may not be discovered prior to shipment to customers, which could result in warranty obligations, reducing our revenue and increasing our cost.

In manufacturing our products, we depend upon third parties for the supply of various components. Many of these components require a significant degree of technical expertise to produce. If our suppliers fail to produce components to specification, or if the suppliers, or we, use defective materials or workmanship in the manufacturing process, the reliability and performance of our products will be compromised.

If our products contain defects that cannot be repaired easily and inexpensively, we may experience:

loss of customer orders and delay in order fulfillment;

damage to our brand reputation;

increased cost of our warranty program due to product repair or replacement;

inability to attract new customers;

diversion of resources from our manufacturing and research and development departments into our service department; and

legal action.

The occurrence of any one or more of the foregoing could materially harm our business.

We forecast sales to determine requirements for components and materials used in our products and if our forecasts are incorrect, we may experience either delays in shipments or increased inventory costs.

We keep limited materials and components on hand. To manage our manufacturing operations with our suppliers, we forecast anticipated product orders and material requirements to predict our inventory needs up to twelve months in advance and enter into purchase orders on the basis of these requirements. Our limited historical experience may not provide us with enough data to accurately predict future demand. If our business expands, our demand for components and materials would increase and our suppliers may be unable to meet our demand. If we overestimate our component and material requirements, we will have excess inventories, which would increase our expenses. If we underestimate our component and material requirements, we may have inadequate inventories, which could interrupt, delay or prevent delivery of our products to our customers. Any of these occurrences would negatively affect our financial performance and the level of satisfaction our customers have with our business.

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Lack of demand for our products in the non-core market would harm our anticipated revenue growth.

Most of our revenue in the United States is derived from sales to customers outside of the core dermatologist and plastic surgeon specialties, such as family practitioners, primary care physicians, gynecologists and medi-spas. Continuing to achieve further penetration into this new market is a material assumption of our growth strategy. Demand for our products in the non-core market could be weakened by several factors including poor financial performance of businesses introducing aesthetic procedures to their practice or medi-spas, reduced patient demand for alternative treatments and services being provided by non-core practitioners and an increase in malpractice law suits against non-core practitioners. If we do not achieve anticipated demand for our products in the non-core market, our expected revenue growth may not be achieved.

We depend on skilled and experienced personnel to operate our business effectively. If we are unable to recruit, hire and retain these employees, our ability to manage and expand our business will be harmed, which would impair our future revenue and profitability.

Our success largely depends on the skills, experience and efforts of our officers and other key employees. We do not have employment contracts with any of our officers or other key employees. Any of our officers and other key employees may terminate their employment at any time. We do not have a succession plan in place for each of our officers and key employees. In addition, we do not maintain key person life insurance policies covering any of our employees. The loss of any of our senior management team members could weaken our management expertise and harm our business.

Our ability to retain our skilled labor force and our success in attracting and hiring new skilled employees will be a critical factor in determining whether we will be successful in the future. We may not be able to meet our future hiring needs or retain existing personnel. We will face particularly significant challenges and risks in hiring, training, managing and retaining engineering and sales and marketing employees. Failure to attract and retain personnel, particularly technical and sales and marketing personnel, would materially harm our ability to compete effectively and grow our business.

Failure to maintain effective internal control over financial reporting could have a material adverse effect on our business, operating results and stock price.

Beginning with the annual report for our fiscal year ended on December 31, 2005, Section 404 of the Sarbanes-Oxley Act of 2002 required us to include a report by our management on our internal control over financial reporting in each of our Annual Reports on Form 10-K. Such reports contain an assessment by management of the effectiveness of our internal control over financial reporting as of the end of our fiscal year and a statement as to whether or not such internal control was effective. Also required to be included in our Annual Report on Form 10-K was an opinion by our Independent Registered Public Accounting Firm on management s assessment of such internal control.

Our efforts to comply with Section 404 have resulted in, and are likely to continue to result in, significant costs, and take up a significant amount of management s time and operational resources. Though we have not historically identified any significant deficiency or material weakness in our internal control over financial reporting, if we are unable to assert that our internal control over financial reporting is effective in our 2007 Annual Repot on Form 10-K and future years, our stock price may decline and it could have an adverse effect on our business.

Any acquisitions that we make could disrupt our business and harm our financial condition.

We expect to evaluate potential strategic acquisitions of complementary businesses, products or technologies. We may also consider joint ventures and other collaborative projects. We may not be able to identify appropriate acquisition candidates or strategic partners, or successfully negotiate, finance or integrate any businesses, products or technologies that we acquire. Furthermore, the integration of any acquisition and management of any collaborative project may divert management s time and resources from our core business and disrupt our operations. We do not have any experience with acquiring companies or products. If we decide to expand our product offerings beyond laser and other light-based products, we may spend time and money on projects that do not increase our revenue.

Any cash acquisition we pursue would diminish our available cash balances to us for other uses, and any stock acquisition would be dilutive to our stockholders. While we from time to time evaluate potential collaborative projects and acquisitions of businesses, products and technologies, and anticipate continuing to make these evaluations, we have no present understandings, commitments or agreements with respect to any acquisitions or collaborative projects.

Anti-takeover provisions in our Amended and Restated Certificate of Incorporation and Bylaws, and Delaware law, contain provisions that could discourage a takeover.

Our Amended and Restated Certificate of Incorporation and Bylaws, and Delaware law, contain provisions that might enable our management to resist a takeover, and might make it more difficult for an investor to acquire a substantial block of our common stock. These provisions include:

- a classified board of directors;
- advance notice requirements to stockholders for matters to be brought at stockholder meetings;
- a supermajority stockholder vote requirement for amending certain provisions of our Amended and Restated Certificate of Incorporation and Bylaws;
- limitations on stockholder actions by written consent; and
- the right to issue preferred stock without stockholder approval, which could be used to dilute the stock ownership of a potential hostile acquirer.

These provisions might discourage, delay or prevent a change in control of our company or a change in our management. The existence of these provisions could adversely affect the voting power of holders of common stock and limit the price that investors might be willing to pay in the future for shares of our common stock.

Our effective income tax rate may vary significantly.

Unanticipated changes in our tax rates could affect our future results of operations. Our future effective tax rates could be unfavorably affected by changing interpretations of existing tax laws or regulations, changes in estimates of prior years items, unanticipated decreases in the amount of revenue or earnings in countries with low statutory tax rates, by changes in the valuation of our deferred tax assets and liabilities, future levels of research & development spending, deductions for employee stock option exercises being different to what we projected, and changes in overall levels of income before taxes.

The quarterly royalty payments under our patent license with Palomar are subject to an annual audit. Any material adjustments from this audit could result in a material adverse effect on our business and our stock price.

We pay royalties to Palomar after each fiscal quarter for applicable product sales made in that quarter. These royalty amounts are subject to an annual review by an independent public accountant hired by Palomar. The independent public accountant s interpretation of the applicable royalty rate for any new products, or

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combination of products, and the net revenue for which to calculate the royalty, could be different from ours. In the event that the independent public accountant s assessment of the accuracy of our estimated royalty payments to Palomar is materially different from our calculations, we could owe a higher amount to Palomar than we accrued for, and would then have to report it as an additional expense in our financial statements for the applicable period. This could result in a material adverse effect on our business and stock price.

Stock-based compensation expense adjustments could adversely affects our reported financial results, which could cause the price of our stock to decline.

As of January 1, 2006, we adopted SFAS 123(R), which requires us to measure and record stock-based compensation expense using a fair value method, which can adversely affect our results of operations by increasing our cost by the amount of such stock-based compensation charges. Determining the appropriate fair value model and calculating the fair value of stock-based payment awards require the input of highly subjective assumptions, which involve inherent uncertainties and the application of management judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be significantly different from what we have recorded in the current period. Actual stock-based compensation expense significantly higher than our expectations would materially decrease our net income and adversely affects our reported financial results, which could cause the price of our stock to decline.

We have not paid dividends in the past and do not expect to pay dividends in the future, and any return on investment may be limited to the value of our stock.

We have never paid cash dividends on our common stock and do not anticipate paying cash dividends on our common stock in the foreseeable future. The payment of dividends on our common stock will depend on our earnings, financial condition and other business and economic factors affecting us at such time as our board of directors may consider relevant. If we do not pay dividends, our stock may be less valuable because a return on investment will only occur if our stock price appreciates.

Any cash acquisition we pursue would diminish our available cash balances to us for other uses, and any stock acquisition would be dilutive to our stockholders. While we from time to time evaluate potential collaborative projects and acquisitions of businesses, products and technologies, and anticipate continuing to make these evaluations, we have no present understandings, commitments or agreements with respect to any acquisitions or collaborative projects.

ITEM 5. OTHER INFORMATION

Change in Composition of Compensation Committee

At our April 13, 2007 meeting of our Board of Directors, Annette J. Campbell-White was appointed by its members to its Compensation Committee, resulting in a Compensation Committee comprised of Ms. Campbell-White, Jerry P. Widman and David B. Apfelberg. Ms. Campbell-White replaced Mr. Mark W. Lortz who resigned as a member of our Compensation Committee effective as of April 13, 2007. Mr. Apfelberg will remain as the Chairperson of our Compensation Committee.

Amendment to 2004 Equity Incentive Plan

At our April 13, 2007 meeting of our Board of Directors, an amendment to our 2004 Equity Incentive Plan to reduce the contractual term of future director option grants, from ten years to seven years was approved. We expect that this modification will result in future reductions to compensation expense related to such option grants. An amended and restated 2004 Equity Incentive Plan is attached hereto on Exhibit 10.14.

Item 6. Exhibits

Exhibit No.	Description
3.2 (1)	Amended and Restated Certificate of Incorporation of the Registrant (Delaware).

3.4 [1]	Bylaws of the Registrant.
4.1 [2]	Specimen Common Stock certificate of the Registrant.
10.14	Cutera, Inc. 2004 Equity Incentive Plan, as amended on April 13, 2007
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 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.

(1) Incorporated by reference from our Registration Statement on Form S-1 (Registration No. 333-111928) which was declared effective on March 30, 2004.
(2) Incorporated by reference from our Annual Report on Form 10-K filed with the SEC on March 25, 2005.

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SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) 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, in the city of Brisbane, State of California, on the 7th day of May 2007.

CUTERA, INC.

/S/ RONALD J. SANTILLI
Ronald J. Santilli

Chief Financial Officer

(Principal Financial Officer and Authorized Signatory)