

AtriCure, Inc.
Form 10-Q
August 14, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2007

or

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

For the transition period from _____ to _____

Commission File Number 000-51470

AtriCure, Inc.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

6033 Schumacher Park Drive

34-1940305
(I.R.S. Employer
Identification No.)

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West Chester, OH 45069

(Address of principal executive offices)

(513) 755-4100

(Registrant's telephone number, including area code)

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

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

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

Large Accelerated Filer Accelerated Filer Non-accelerated Filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding at August 10, 2007 |
|--------------------------------|--------------------------------|
| Common Stock, \$.001 par value | 14,122,186 |

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

ATRICURE, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

| | June 30, 2007 | December 31, 2006 |
|---|------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 27,736,249 | \$ 14,890,383 |
| Short-term investments | 999,380 | 4,598,032 |
| Accounts receivable, less allowance for doubtful accounts of \$77,976 and \$343,127, respectively | 7,247,903 | 6,562,342 |
| Inventories, net | 3,976,143 | 3,389,400 |
| Other current assets | 988,402 | 1,247,738 |
| Total current assets | 40,948,077 | 30,687,895 |
| Property and equipment, net | 4,169,754 | 3,643,069 |
| Intangible assets, net | 665,778 | 772,778 |
| Goodwill | 3,840,837 | 3,840,837 |
| Other assets | 153,463 | 183,486 |
| Total assets | \$ 49,777,909 | \$ 39,128,065 |
| Liabilities and stockholders equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 5,662,273 | \$ 3,608,983 |
| Accrued liabilities | 3,143,965 | 3,656,441 |
| Current maturities of long-term debt and capital leases | 407,513 | 391,460 |
| Total current liabilities | 9,213,751 | 7,656,884 |
| Long-term debt and capital leases | 484,693 | 692,544 |
| Other liabilities | 337,500 | 84,375 |
| Total liabilities | 10,035,944 | 8,433,803 |
| Commitments and contingencies (Note 5) | | |
| Stockholders equity: | | |
| Common stock, \$.001 par value, 90,000,000 shares authorized and 14,121,134 and 12,188,600 issued and outstanding, respectively | 14,121 | 12,189 |
| Additional paid-in capital | 102,938,474 | 86,646,064 |
| Accumulated other comprehensive (loss) income | (66,455) | 90,673 |
| Accumulated deficit | (63,144,175) | (56,054,664) |

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| | | |
|--|---------------|---------------|
| Total stockholders' equity | 39,741,965 | 30,694,262 |
| Total liabilities and stockholders' equity | \$ 49,777,909 | \$ 39,128,065 |

See accompanying notes to condensed consolidated financial statements.

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ATRICURE, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|----------------|---------------------------|----------------|
| | 2007 | 2006 | 2007 | 2006 |
| Revenues | \$ 12,352,219 | \$ 9,649,038 | \$ 23,102,989 | \$ 18,285,846 |
| Cost of revenues | 2,547,152 | 1,785,417 | 4,757,647 | 3,385,158 |
| Gross profit | 9,805,067 | 7,863,621 | 18,345,342 | 14,900,688 |
| Operating expenses: | | | | |
| Research and development expenses | 2,927,984 | 2,928,171 | 6,057,262 | 5,838,664 |
| Selling, general and administrative expenses | 10,036,836 | 8,488,970 | 20,320,023 | 15,985,068 |
| Total operating expenses | 12,964,820 | 11,417,141 | 26,377,285 | 21,823,732 |
| Loss from operations | (3,159,753) | (3,553,520) | (8,031,943) | (6,923,044) |
| Other income (expense): | | | | |
| Interest expense | (45,509) | (53,084) | (92,945) | (107,997) |
| Interest income | 221,228 | 325,631 | 418,587 | 660,297 |
| Grant income | 74,190 | 72,632 | 412,333 | 72,632 |
| Foreign currency transaction gain | 122,754 | | 204,457 | |
| Net loss | \$ (2,787,090) | \$ (3,208,341) | \$ (7,089,511) | \$ (6,298,112) |
| Basic and diluted loss per share | \$ (0.22) | \$ (0.26) | \$ (0.56) | \$ (0.52) |
| Weighted average shares outstanding- | | | | |
| Basic and diluted | 12,943,884 | 12,118,032 | 12,622,937 | 12,107,116 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**ATRICURE, INC. AND SUBSIDIARY****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

| | Six Months Ended June 30, | |
|--|----------------------------------|----------------------|
| | 2007 | 2006 |
| Cash flows from operating activities: | | |
| Net loss | \$ (7,089,511) | \$ (6,298,112) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | 914,818 | 753,193 |
| Amortization of intangible assets | 107,000 | 107,000 |
| Amortization of warrants | 24,462 | 24,462 |
| Loss (gain) on disposal of equipment | 6,852 | (20,000) |
| (Benefit from) provision for losses on accounts receivable | (99,720) | 56,231 |
| Share-based compensation expense | 882,999 | 468,927 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (585,842) | (770,243) |
| Inventories, net | (586,742) | (920,526) |
| Other current assets | 255,872 | 346,511 |
| Accounts payable | 996,753 | 51,039 |
| Accrued liabilities | (702,798) | (69,041) |
| Other non-current assets and other non-current liabilities | 253,125 | 45,006 |
| Net cash used in operating activities | (5,622,732) | (6,225,553) |
| Cash flows from investing activities: | | |
| Purchases of property & equipment | (1,441,494) | (643,486) |
| Purchases of available-for-sale securities | | (5,479,649) |
| Maturities of available-for-sale securities | 3,608,000 | 4,865,000 |
| Net cash provided by (used in) investing activities | 2,166,506 | (1,258,135) |
| Cash flows from financing activities: | | |
| Payments on long-term debt and capital leases | (191,798) | (182,332) |
| Proceeds from stock option exercises | 151,345 | 37,598 |
| Gross proceeds from private placement of common shares | 16,499,997 | |
| Net cash provided by (used in) financing activities | 16,459,544 | (144,734) |
| Effect of exchange rate changes on cash | (157,452) | 9,944 |
| Net increase (decrease) in cash and cash equivalents | 12,845,866 | (7,618,478) |
| Cash and cash equivalents - beginning of period | 14,890,383 | 27,432,948 |
| Cash and cash equivalents - end of period | \$ 27,736,249 | \$ 19,814,470 |
| Supplemental cash flow information: | | |
| Cash paid for income taxes | \$ | \$ 51,534 |
| Cash paid for interest | \$ 40,357 | \$ 96,750 |
| Non-cash investing and financing activities: | | |
| Proceeds from sale of equipment in accounts receivable | \$ | \$ 20,000 |
| Purchases of property & equipment in current liabilities | \$ 218,040 | \$ 118,708 |

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| | | |
|--|--------------|----|
| Accrued issuance costs from private placement | \$ 1,240,000 | \$ |
| See accompanying notes to condensed consolidated financial statements. | | |

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ATRICURE, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of the Business AtriCure, Inc. (the Company) was incorporated in the State of Delaware on October 31, 2000, as a spin-off of Enable Medical Corporation, to focus on the surgical treatment of atrial fibrillation, a rapid, irregular quivering of the upper chambers of the heart. AtriCure Europe B.V. is the Company's wholly owned subsidiary, which was incorporated in the Netherlands. The Company sells its medical devices to hospitals and medical clinics both in the United States and internationally. International sales were approximately \$1.5 million and \$1.3 million for the three months ended June 30, 2007 and 2006, respectively and \$2.7 million and \$2.1 million for the six months ended June 30, 2007 and 2006.

Basis of Presentation The accompanying interim financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission. The accompanying interim financial statements are unaudited, but in the opinion of management, contain all the normal, recurring adjustments considered necessary to present fairly the financial position, results of operations and cash flows for the periods presented in conformity with generally accepted accounting principles applicable to interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been omitted or condensed. The Company believes the disclosures herein are adequate to make the information presented not misleading. Results of operations are not necessarily indicative of the results expected for the full fiscal year or for any future period.

The accompanying condensed consolidated financial statements should be read in conjunction with the audited financial statements of the Company 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 on April 2, 2007.

Principles of Consolidation The condensed consolidated financial statements include the accounts of the Company and AtriCure Europe B.V. Intercompany accounts and transactions are eliminated.

Revenue Recognition Revenues are generated primarily from the sale of the Company's disposable surgical products. Pursuant to the Company's standard terms of sale, revenues are recognized when title to the goods and risk of loss transfers to customers and there are no remaining obligations that will affect the customers' final acceptance of the sale. Generally, the Company's standard terms of sale define the transfer of title and risk of loss to occur upon shipment to the respective customer. The Company maintains no post-shipment obligations to the recipients of the products. No installation, calibration or testing of this equipment is performed by the Company subsequent to shipment to the customer in order to render it operational. Product revenue includes shipping revenues of approximately \$100,000 and \$61,000 for the three months ended June 30, 2007 and 2006, respectively and \$173,000 and \$105,000 for the six months ended June 30, 2007 and 2006. Cost of freight is included in cost of goods sold. Sales taxes collected from customers and remitted to governmental authorities are excluded from product revenues. The Company sells its products through a direct and indirect sales force and through AtriCure Europe B.V. Terms of sale are generally consistent for both end-users and distributors and payment terms are generally net 30 days. Customers generally have no right of return.

The Company complies with the Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 101, Recognition in Financial Statements (SAB 101), as amended by SAB 104. SAB 101 sets forth guidelines on the timing of revenue recognition based upon factors such as passage of title, installation, payment terms and ability to

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return products. The Company recognizes revenue when all of the following criteria are met: (i) persuasive evidence that an arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is fixed or determinable; and (iv) collectibility is reasonably assured.

Sales Returns and Allowances. The Company maintains an allowance for sales returns and allowances as a result of defective or damaged products or when price reductions are given to customers. The allowance for sales returns and allowances is reviewed periodically and is adjusted on a specific identification basis. Increases to the allowance results in a reduction of revenue.

Allowance for Uncollectible Accounts Receivable. The Company systematically evaluates the collectibility of accounts receivable and determines the appropriate reserve for doubtful accounts. In determining the amount of the reserve, the Company considers aging of account balances, historical credit losses, other customer-specific information, and any other relevant factors or considerations. Increases to the allowance for doubtful accounts result in a corresponding expense. Periodically, the Company reviews accounts receivable and adjusts the allowance based on current circumstances and charges off uncollectible receivables against the allowance when all attempts to collect the receivable have failed.

Inventories, net Inventories are stated at the lower of cost or market using the first-in, first-out (FIFO) cost method and consist of the following:

| | June 30, 2007 | December 31, 2006 |
|--------------------------|---------------------|----------------------|
| Raw material | \$ 949,209 | \$ 763,862 |
| Work in process | 1,342,150 | 1,086,685 |
| Finished goods | 1,783,177 | 1,633,520 |
| Reserve for obsolescence | (98,393) | (94,667) |
| Inventories, net | \$ 3,976,143 | \$ 3,389,400 |

Loss Per Share Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Since the Company has experienced losses for all periods presented, net loss per share excludes the effect of 2,191,622 and 2,003,227 options outstanding at June 30, 2007 and 2006, respectively, because such options are anti-dilutive. Therefore, the number of shares calculated for basic net loss per share is also used for the diluted net loss per share calculation.

Accumulated Other Comprehensive Income (Loss) Other comprehensive income (loss), net of tax, consisted of the following:

| | Unrealized Gains on Investments | Foreign Currency Translation Adjustment | Accumulated Other Comprehensive Income (Loss) |
|------------------------------------|---------------------------------------|--|--|
| Balance as of December 31, 2006 | \$ 4,786 | \$ 85,887 | \$ 90,673 |
| Current-period change | 324 | (157,452) | (157,128) |
| Balance as of June 30, 2007 | \$ 5,110 | \$ (71,565) | \$ (66,455) |

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Comprehensive Income (Loss) Comprehensive loss, net of tax, consisted of the following:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|------------------------------------|----------------|----------------------------------|----------------|
| | 2007 | 2006 | 2007 | 2006 |
| Net loss | \$ (2,787,090) | \$ (3,208,341) | \$ (7,089,511) | \$ (6,298,112) |
| Unrealized gains (losses) on investments | 704 | (3,987) | 324 | (18,214) |
| Unrealized gains (losses) from foreign currency translation adjustments | (105,307) | 2,813 | (157,452) | 9,944 |
| Comprehensive loss | \$ (2,891,693) | \$ (3,209,515) | \$ (7,246,639) | \$ (6,306,382) |

Foreign Currency Transaction Gain The Company's wholly owned subsidiary recorded foreign currency transaction gains of \$122,754 and \$204,457 for the three and six months ended June 30, 2007, respectively, in connection with a partial settlement of its intercompany payable balance with the Company.

Income taxes The Company classifies interest and penalties associated with income tax liabilities as income tax expense. There was no income tax related interest or penalties accrued or paid for the periods presented.

Reclassification The Company reclassified certain prior period financial statement balances to conform to the current year presentation, including invoice accruals to accounts payable from accrued liabilities in 2006 and certain reclassifications from changes in assets and liabilities within the operating section to reconcile net loss to net cash used in operating activities.

Use of Estimates The preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair Value Disclosures The fair value of the Company's assets and liabilities approximates the carrying values.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140 (SFAS 155)*. SFAS 155 amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* and SFAS 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The provisions of SFAS 155 are effective for financial instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of SFAS No. 155 in 2007 did not have a material impact on the Company's financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements (SFAS 157)*, which establishes a framework for measuring fair value and expands disclosures about fair value measurements. The provisions of SFAS 157 will be effective for the Company beginning January 1, 2008. The Company is in the process of determining the effect, if any, the adoption of SFAS 157 will have on its financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115*, which permits entities to measure many financial instruments and certain other items at fair value. The provisions of SFAS 159 will be effective for the Company beginning January 1, 2008. The Company is in the process of determining the effect, if any, the adoption of SFAS 159 will have on its financial statements.

Table of Contents**3. INVESTMENTS**

Investments consisted of the following:

| | Cost Basis | Unrealized Gains | Unrealized Losses | Fair Value |
|---------------------------------|---------------------|---------------------|----------------------|---------------------|
| June 30, 2007 | | | | |
| U.S. Government securities | \$ 999,056 | \$ 886 | \$ (562) | \$ 999,380 |
| December 31, 2006 | | | | |
| U.S. Government securities | \$ 1,787,804 | \$ 6,700 | | \$ 1,794,504 |
| Medium-term notes | 1,001,179 | | (1,059) | 1,000,120 |
| Corporate notes | 1,804,263 | | (855) | 1,803,408 |
| Total | \$ 4,593,246 | \$ 6,700 | \$ (1,914) | \$ 4,598,032 |
| Total unrealized gains (losses) | | \$ 7,586 | \$ (2,476) | |

The Company has not experienced any significant realized gains or losses on its investments in the periods presented in the Condensed Consolidated Statements of Operations.

4. ACCRUED LIABILITIES

Accrued liabilities consisted of the following:

| | June 30, 2007 | December 31, 2006 |
|----------------------------------|---------------------|----------------------|
| Accrued commissions | \$ 1,042,110 | \$ 1,415,667 |
| Accrued bonus | 509,100 | 695,101 |
| Accrued vacation | 434,790 | 430,172 |
| Other accrued liabilities | 1,157,965 | 1,115,501 |
| Total accrued liabilities | \$ 3,143,965 | \$ 3,656,441 |

5. COMMITMENTS AND CONTINGENCIES

The Company is not party to any material pending or threatened litigation, except as described below:

Class Action Lawsuit

The Company and certain of its current and former officers were named as defendants in a purported securities class action lawsuit filed in the United States District Court for the Southern District of New York (Levine v. AtriCure, Inc., Case No. 06 CV 14324 (United States District Court for the Southern District of New York)). The suit alleges violations of the federal securities laws and seeks damages on behalf of purchasers of the Company's common stock during the period from the Company's Initial Public Offering in August 2005 through February 16, 2006. The Company believes that the allegations are without merit and intends to vigorously defend against them, and the Company's motion to dismiss this suit is currently pending.

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Life Support Technology, LST b.v.

Multiple proceedings existed between Life Support Technology, LST b.v. (LST), a former distributor of the Company's products in Europe, and the Company. In January 2006, LST filed an action against the Company in Den Bosch, Netherlands and in March 2006 the Company brought an action in Ohio against LST. These claims were tentatively settled in April 2007. As a result of the tentative settlement agreement, the Company agreed to pay LST 257,334 Euros, or approximately \$350,000, on an interest-free basis in quarterly installments over a four-year period, beginning in 2007. The present value of these payments, \$300,000, was accrued as of June 30, 2007.

The Company may from time to time become a party to additional legal proceedings.

6. INCOME TAX PROVISION

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109 (FIN 48), which became effective for the Company beginning on January 1, 2007. FIN 48 addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. The impact of the Company's reassessment of its tax positions in accordance with FIN 48 did not have a material effect on the results of operations, financial condition or liquidity.

The Company adopted the provisions of FIN 48 at the beginning of 2007. Adoption of FIN 48 on January 1, 2007 did not result in a cumulative effect adjustment to retained earnings. The Company does not expect that the amount of unrecognized tax benefits will change in the next twelve months.

The Company is subject to U.S. federal income tax as well as income tax of multiple state and local jurisdictions. The Company is no longer subject to U. S. federal income tax examinations for years before 2003 and is no longer subject to state and local income tax examinations by tax authorities for years before 2002.

7. STOCKHOLDER S EQUITY

On May 30, 2007, the Company completed a private placement of 1,789,649 shares of common stock with gross proceeds to the Company of \$16,499,977. Of the total shares issued, 1,683,060 shares were issued to ten institutional investors at \$9.15 per share and 106,589 shares were issued to an entity affiliated with one of our directors at \$10.32 per share. Net proceeds to the Company will be approximately \$15,200,000 after deducting transaction expenses. The net proceeds from the offering will be used for working capital and general purposes, including research and development activities and potential acquisitions or other strategic initiatives. As of June 30, 2007, \$1,240,000 of expenses related to the transaction are recorded as a current liability.

8. EQUITY COMPENSATION PLANS

As of June 30, 2007, the Company had two equity compensation plans: the 2001 Stock Option Plan (the 2001 Plan) and the 2005 Equity Incentive Plan (the 2005 Plan). The 2001 plan is no longer used for the granting of options.

Under the 2005 Plan, the Board of Directors may grant incentive stock options to employees and any parent or subsidiary's employees, and may grant nonstatutory stock options, stock purchase rights, restricted stock, stock appreciation rights, performance units or performance shares to employees, directors and consultants of the Company and any parent or subsidiary's employees, directors and consultants. The administrator (which is made up of the

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Company's board of directors or a committee of the board) has the power to determine the terms of any awards, including the exercise price of options, the number of shares subject to each award, the exercisability of the awards and the form of consideration.

Options granted under the 2001 and 2005 Plans generally expire 10 years from the date of grant. Options granted from the 2001 plan are generally exercisable beginning one year from the date of grant in cumulative yearly amounts of 25% of the shares granted. Options granted from the 2005 plan generally vest at a rate of 25% on the first anniversary date and ratably each month thereafter. Certain options issued were exercisable upon grant and the underlying unvested shares are subject to the Company's repurchase right as stated in the applicable plan agreement.

Under the 2005 Plan, 2,775,751 shares of common stock were reserved for issuance as of June 30, 2007. In addition, the shares reserved for issuance under the 2005 plan include (a) shares reserved but unissued under the 2001 Plan as of August 10, 2005, (b) shares returned to the 2001 Plan as the result of termination of options or the repurchase of shares issued under such plan, and (c) annual increases in the number of shares available for issuance on the first day of each year equal to the lesser of:

3.25% of the outstanding shares of common stock on the first day of the fiscal year;

825,000 shares; or

an amount the Company's board of directors may determine.

On January 1, 2007 and 2006, an additional 396,130 and 392,676 shares, respectively, were authorized for issuance under the 2005 Equity Incentive Plan representing 3.25% of the outstanding shares on those dates.

As of June 30, 2007, 3,481,724 shares of the Company's common stock were reserved for issuance under the Company's 2001 and 2005 equity compensation plans.

Activity under the Plans was as follows:

| | Number of Shares Outstanding | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|--------------------------------|------------------------------------|--|---|---------------------------------|
| Outstanding at January 1, 2007 | 1,906,928 | \$ 6.79 | | |
| Granted | 516,591 | \$ 10.53 | | |
| Forfeited | (89,012) | \$ 10.10 | | |
| Exercised | (142,885) | \$ 1.06 | | |
| Outstanding at June 30, 2007 | 2,191,622 | \$ 7.91 | 7.98 | \$ 5,011,318 |
| Expected to vest | 1,994,950 | \$ 7.69 | 7.86 | \$ 4,950,400 |
| Exercisable at June 30, 2007 | 878,320 | \$ 4.62 | 6.35 | \$ 4,354,604 |

As of June 30, 2007, there were 1,290,102 shares available for future grants under the Plans.

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The total intrinsic value of options exercised during the three months ended June 30, 2007 and 2006 was approximately \$258,000 and \$42,000 respectively, and was approximately \$1,207,000 and \$247,000 during the six months ended June 30, 2007 and 2006, respectively. Due to the Company's current tax position, no tax benefit was recognized as a result of option exercises for the three and six months ended June 30, 2007 and 2006. Additionally,

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there was no impact on operating or financing activities in the Company's Condensed Consolidated Statement of Cash Flows for the six months ended June 30, 2007 and 2006 as a result of the exercise of stock options, other than the recognition of \$151,345 and \$37,598, respectively, in cash receipts as a result of stock option exercises.

The exercise price per share of each option is equal to the fair market value of the underlying share on the date of grant. The Company issues registered shares of common stock to satisfy stock option exercises.

Valuation and Expense Information under FAS 123(R)

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS 123(R)), which requires the measurement and recognition of compensation expense for all share-based payment awards made to the Company's employees and directors based on fair values. The following table summarizes stock-based compensation expense related to employee stock options under SFAS 123(R), which was allocated as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|------------|---------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| Cost of revenues | \$ 21,474 | \$ 8,914 | \$ 37,173 | \$ 17,892 |
| Research and development | 51,894 | 35,909 | 91,021 | 70,620 |
| Selling, general and administrative | 177,537 | 209,854 | 414,075 | 382,180 |
| Total stock-based compensation expense related to employee stock options | \$ 250,905 | \$ 254,677 | \$ 542,269 | \$ 470,692 |
| Impact on reported basic and diluted loss per share | \$ 0.02 | \$ 0.02 | \$ 0.04 | \$ 0.04 |

In calculating the compensation costs under SFAS 123 and SFAS 123(R), the fair value of the options is estimated on the grant date using the Black-Scholes model considering the following assumptions:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------------------------|-----------------------------|------------|---------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| Risk free interest rate | 4.56-5.07% | 1.00-5.14% | 4.56-5.07% | 1.00-5.14% |
| Expected life of option (years) | 6.0 | 6.0 | 6.0 | 6.0 |
| Expected volatility of stock | 44.00% | 38.06% | 44.00%-45.00% | 38.06% |
| Weighted-average volatility | 44.00% | 38.06% | 44.29% | 38.06% |
| Dividend yield | 0.00% | 0.00% | 0.00% | 0.00% |

The risk-free interest rate assumption is based upon the U.S. treasury yield curve at the time of grant for a time period equal to the expected option life.

Due to the Company's limited operating history, the expected lives and volatility are estimated based on other companies in the industry.

Due to the Company's limited trading history, the Company used the implied volatility of a group of comparable companies, looking at both short and long-dated options in determining the Company's volatility.

Based on the assumptions noted above, the weighted average estimated fair values of the options granted in the three and six months ended June 30, 2007 and 2006 were as follows:

| | Three months ended June 30, | | Six months ended June 30, | |
|--|-----------------------------|---------|---------------------------|---------|
| | 2007 | 2006 | 2007 | 2006 |
| Weighted average fair value of options granted | \$ 4.88 | \$ 3.98 | \$ 5.23 | \$ 4.16 |

Table of Contents**Non-Employee Stock Compensation**

The Company has issued non-qualified common stock options to consultants to purchase shares of common stock. Such options vest over a service period ranging from immediately to four years. The fair value at the date of grant, which is subject to adjustment at each vesting date based upon the fair value of the Company's common stock, was determined using the Black-Scholes model with the following assumptions:

| | Six Months Ended June 30, 2007 |
|---------------------------------|---------------------------------------|
| Risk free interest rate | 4.73% |
| Expected life of option (years) | 6.0 |
| Expected volatility of stock | 45.00% |
| Weighted-average volatility | 45.00% |
| Dividend yield | 0.00% |

There were no non-employee stock options granted during the three months ended June 30, 2007 and 2006 and during the six months ended June 30, 2006.

The values attributable to these options have been amortized over the service period on a graded vesting method and the vested portion of these options was re-measured at each vesting date.

Stock compensation (income) expense with respect to non-employee awards was \$(9,800) and \$(17,000) for the three months ended June 30, 2007 and 2006, respectively and totaled approximately \$340,700 and \$2,000 for the six months ended June 30, 2007 and 2006, respectively.

9. SEGMENT AND GEOGRAPHIC INFORMATION

The Company considers reporting segments in accordance with SFAS 131, Disclosure about Segments of an Enterprise and Related Information. The Company develops, manufactures, and sells surgical devices designed to create precise lesions, or scars, in cardiac and soft tissues. These devices are developed and marketed to a broad base of customers in the United States and internationally. Management considers all such sales to be part of a single operating segment.

Geographic revenues are as follows:

| | Three Months Ended | | Six Months Ended June 30, | |
|---------------|---------------------------|---------------------|----------------------------------|----------------------|
| | June 30, | | June 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| United States | \$ 10,828,856 | \$ 8,385,099 | \$ 20,356,928 | \$ 16,192,578 |
| International | 1,523,363 | 1,263,939 | 2,746,061 | 2,093,268 |
| Total | \$ 12,352,219 | \$ 9,649,038 | \$ 23,102,989 | \$ 18,285,846 |

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Substantially all of the Company's long-lived assets are located in the United States.

10. SUBSEQUENT EVENT

On August 8, 2007, AtriCure acquired the Frigitronics® CCS-200 product line for use in cardiovascular cryosurgery and certain related assets from Cooper Surgical, Inc. for an aggregate purchase price of \$3,661,536. The acquired product line includes the Frigitronics® CCS-200 console, which is currently used in combination with a variety of reusable cardiac ablation probes. In consideration for the product line and related assets, AtriCure agreed to pay Cooper \$3,661,536, of which \$3,244,244 was paid in cash on August 8, 2007 and the balance, \$417,292, is payable to Cooper under an unsecured promissory note that bears interest at 5%. The promissory note is payable in full within three days following the completion by Cooper of defined manufacturing services and delivery to AtriCure of all remaining tangible assets acquired.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying condensed consolidated financial statements and notes thereto contained in Item 1 of Part I of this Form 10-Q and our audited financial statements and notes thereto as of and for the year ended December 31, 2006 included in our Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission on April 2, 2007, to provide an understanding of our results of operations, financial condition and cash flows.

Forward-Looking Statements

This Form 10-Q, including the sections titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors," contains forward-looking statements regarding our future performance. All forward-looking information is inherently uncertain and actual results may differ materially from assumptions, estimates or expectations reflected or contained in the forward-looking statements as a result of various factors, including those set forth under "Risk Factors" and elsewhere in this quarterly report on Form 10-Q, and in our annual report on Form 10-K for the year ended December 31, 2006. Forward-looking statements convey our current expectations or forecasts of future events. All statements contained in this Form 10-Q other than statements of historical fact are forward-looking statements. Forward-looking statements include statements regarding our future financial position, business strategy, budgets, projected costs, plans and objectives of management for future operations. The words "may," "continue," "estimate," "intend," "plan," "will," "believe," "project," "expect," "anticipate" and other expressions may identify forward-looking statements, but the absence of these words does not necessarily mean that a statement is not forward-looking. With respect to the forward-looking statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

These forward-looking statements speak only as of the date of this Form 10-Q. Unless required by law, we undertake no obligation to publicly update or revise any forward-looking statements to reflect new information or future events or otherwise.

Overview

We develop, manufacture and sell innovative surgical devices designed to create precise lesions, or scars, in cardiac and soft tissues. Our primary product line is our AtriCure Isolator® bipolar ablation system. Our Isolator® system consists of a compact power generator, multiple configurations of our Isolator® bipolar ablation clamps and our multifunctional bipolar Pen. We sell two configurations of our Isolator® clamps, one designed for ablation during open-heart procedures and one designed for ablation during minimally invasive procedures, which are performed on patients who are not undergoing a separate open-heart procedure. On July 5, 2007, our Isolator® bipolar ablation clamp system received 510(k) clearance from the Food and Drug Administration, or FDA, for the ablation of cardiac tissue. We believe that our Isolator® system is the only bipolar radio-frequency clamp system that has been cleared by the FDA for the ablation of cardiac tissue.

Medical journals have described the adoption by leading cardiothoracic surgeons of our Isolator® clamps as a treatment alternative during open-heart surgical procedures to create lesions in cardiac tissue to block the abnormal electrical impulses that cause atrial fibrillation, or AF, a rapid, irregular quivering of the upper chambers of the heart. Additionally, leading cardiothoracic surgeons have described our Isolator® clamps as a promising treatment alternative for patients who may be candidates for minimally invasive sole-therapy procedures.

During the first quarter of 2007, we introduced the new Isolator Synergy® ablation clamps for ablation during open-heart procedures, which are the next generation of our Isolator® clamps for open-heart procedures.

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We also sell a pen-shaped ablation device known as the multifunctional bipolar Pen, which has been cleared by the FDA for the surgical ablation of cardiac tissue and for temporary pacing, sensing, stimulating and recording during the evaluation of cardiac arrhythmias. Because of its broad range of capabilities, surgeons are using this device during both open-heart and minimally invasive sole-therapy procedures in combination with our Isolator® clamps. We released the Pen for sale in the third quarter of 2005.

Additionally, we are developing the Cosgrove-Gillinov Left Atrial Appendage Occlusion Clip, which is designed to exclude the left atrial appendage, the small appendage that is attached to the left atrium and may be a source for thrombus formation in patients with AF. During the first quarter of 2007, we filed with the FDA a 510(k) notification for the Clip for use in left atrial appendage exclusion. The FDA has requested additional information in order to continue their review of the 510(k) submission for the Clip and suggested in their letter that clinical data may be necessary. We are currently in the process of responding to the FDA's request for additional information.

We currently sell our Isolator® system to customers in the United States primarily through our direct sales force. Our European subsidiary, based in the Netherlands, markets and sells our products throughout Europe, primarily through distributors. Additionally, we sell our products to other international distributors, primarily in Asia, Central America, South America, Canada and the Middle East. Our business is primarily transacted in U.S. dollars, with the exception of transactions with our European subsidiary, which are transacted in Euros. Our sales outside of the United States constituted 12% and 11% of our total revenues for the six months ended June 30, 2007 and 2006, respectively. We expect international revenues to be relatively constant as a percentage of total revenues for the foreseeable future.

None of our products have been approved by the FDA for the treatment of AF. While the FDA does not prevent doctors from using products off-label, we cannot legally market a product for an off-label use. Because our Isolator® system is currently our only significant product line, the sustainability of our current operations, as well as our future viability, is dependent upon the continuation of sales of our Isolator® system. We believe that minimally invasive sole-therapy treatment for AF represents the largest growth opportunity for us. We are in the process of conducting clinical trials and if these trials are successful, we intend to seek FDA approval as early as 2009 for the use of our Isolator® system to treat AF, which we view as our market opportunity. In September 2006, we expanded our CE Mark indications and received approval to market our Isolator® clamps for the treatment of cardiac arrhythmias, including atrial fibrillation.

In August of 2007, The Centers for Medicare & Medicaid, or CMS, issued the final 2008 Inpatient Prospective System (IPPS) final rule for hospital inpatient reimbursement by Medicare's Severity Diagnostic Related Groups, or MS-DRGs, effective October 1, 2007. Under the 2008 IPPS, reimbursement will consider the severity of the patient's illness. Based on our preliminary interpretation of the final rule, we do not expect these changes to have a material impact on our business or revenues.

On May 30, 2007, we completed a private placement of 1,789,649 shares of common stock with gross proceeds to us of \$16.5 million. Of the total shares issued, 1,683,060 shares were issued to ten institutional investors at \$9.15 per share and 106,589 shares were issued to an entity affiliated with one of our directors at \$10.32 per share, the closing bid price on May 23, 2007. Net proceeds to us from the sale of the shares are expected to be approximately \$15.2 million after deducting transaction expenses. The net proceeds from the offering will be used for working capital and general purposes, including research and development activities and potential acquisitions or other strategic initiatives.

On August 8, 2007, we acquired the Frigitronics® CCS-200 product line for use in cardiovascular cryosurgery and certain related assets from Cooper Surgical, Inc. for an aggregate purchase price of \$3.6 million. The acquired product line includes the Frigitronics® CCS-200 console, which is currently used in combination with a variety of reusable cardiac ablation probes. Prior to the acquisition, we were the exclusive worldwide distributor of the product line.

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Our costs and expenses consist of cost of revenues, research and development expenses and selling, general and administrative expenses. Cost of revenues consists principally of the cost of purchasing materials and manufacturing our products. Research and development expenses consist principally of expenses incurred with respect to internal and external research and development activities and the conduct of clinical trials. Selling, general and administrative expenses consist principally of costs associated with our sales, marketing and administrative functions, accounting and legal fees and unrestricted educational grants to medical institutions.

Results of Operations**Three months ended June 30, 2007 compared to June 30, 2006**

The following table sets forth, for the periods indicated, our results of operations expressed as dollar amounts and as percentages of total revenues:

| | Three Months Ended June 30, 2007 | | 2006 | |
|--|-------------------------------------|-----------------|------------|-----------------|
| | Amount | Revenue % of | Amount | Revenue % of |
| Revenues | \$ 12,352 | 100.0% | \$ 9,649 | 100.0% |
| Cost of revenues | 2,547 | 20.6% | 1,785 | 18.5% |
| Gross profit | 9,805 | 79.4% | 7,864 | 81.5% |
| Operating expenses: | | | | |
| Research and development expenses | 2,928 | 23.7% | 2,928 | 30.3% |
| Selling, general and administrative expenses | 10,037 | 81.3% | 8,489 | 88.0% |
| Total operating expenses | 12,965 | 105.0% | 11,417 | 118.3% |
| Loss from operations | (3,160) | (25.6%) | (3,553) | (36.8%) |
| Other income (expense): | | | | |
| Interest expense | (45) | (0.4%) | (53) | (0.6%) |
| Interest income | 221 | 1.8% | 325 | 3.4% |
| Grant income | 74 | 0.6% | 73 | 0.8% |
| Foreign currency transaction gain | 123 | 1.0% | | 0.0% |
| Net loss | \$ (2,787) | (22.6%) | \$ (3,208) | (33.2%) |

Revenues. Total revenues increased \$2.7 million, or 28.0%, from \$9.6 million for the three months ended June 30, 2006 to \$12.4 million for the three months ended June 30, 2007. The increase in revenues was primarily due to an increase in unit sales, both domestically and internationally.

Cost of revenues. Cost of revenues increased \$0.8 million, from \$1.8 million for the three months ended June 30, 2006 to \$2.5 million for the three months ended June 30, 2007. The increase was primarily due to an increase in the total number of units sold. As a percentage of revenues, cost of revenues increased from 18.5% for the three months ended June 30, 2006 to 20.6% for the three months ended June 30, 2007. The increase in cost of revenues as a percentage of revenues was primarily due to an increased proportion of new products, which initially carry a higher product cost.

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Research and development expenses. Research and development expenses of \$2.9 million remained constant for the three months ended June 30, 2007 and 2006. As a percentage of revenues, research and development expenses decreased from 30.3% for the three months ended June 30, 2006 to 23.7% for the three months ended June 30, 2007. We anticipate a continued increase in absolute dollars in research and development costs for the remainder of 2007 as a result of costs associated with the continued expansion of product development initiatives and clinical trials.

Selling, general and administrative expenses. Selling, general and administrative expenses increased \$1.5 million, from \$8.5 million for the three months ended June 30, 2006 to \$10.0 million for the three months ended June 30, 2007. The increase was primarily attributable to an increase in headcount-related charges, primarily in sales and marketing of \$0.9 million and an increase in marketing expenditures of \$0.5 million, primarily due to increased marketing activities, such as tradeshows. As a percentage of total revenues, selling, general and administrative expenses decreased from 88.0% for the three months ended June 30, 2006 to 81.3% for the three months ended June 30, 2007. Selling, general and administrative costs are expected to remain relatively consistent for the remainder of 2007.

Net interest income. Net interest income decreased \$0.1 million, from \$0.3 million for the three months ended June 30, 2006 to \$0.2 million for the three months ended June 30, 2007, due to the decrease in average cash, cash equivalents and investments outstanding.

Foreign currency transaction gain. Foreign currency transaction gain was \$0.1 million for the three months ended June 30, 2007 and is related to the partial settlement of an intercompany account with AtriCure Europe B.V.

Six months ended June 30, 2007 compared to June 30, 2006

The following table sets forth, for the periods indicated, our results of operations expressed as dollar amounts and as percentages of total revenues:

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| | Six Months Ended June 30, | | | |
|--|---------------------------|---------|------------------------|---------|
| | 2007 | 2006 | (dollars in thousands) | |
| | Amount | Revenue | Amount | Revenue |
| | | % of | | % of |
| Revenues | \$ 23,103 | 100.0% | \$ 18,286 | 100.0% |
| Cost of revenues | 4,758 | 20.6% | 3,385 | 18.5% |
| Gross profit | 18,345 | 79.4% | 14,901 | 81.5% |
| Operating expenses: | | | | |
| Research and development expenses | 6,057 | 26.2% | 5,839 | 31.9% |
| Selling, general and administrative expenses | 20,320 | 88.0% | 15,985 | 87.4% |
| Total operating expenses | 26,377 | 114.2% | 21,824 | 119.3% |
| Loss from operations | (8,032) | (34.8%) | (6,923) | (37.9%) |
| Other income (expense): | | | | |
| Interest expense | (93) | (0.4%) | (108) | (0.7%) |
| Interest income | 419 | 1.8% | 660 | 3.6% |
| Grant income | 412 | 1.8% | 73 | 0.4% |
| Foreign currency transaction gain | 204 | 0.9% | | 0.0% |
| Net loss | \$ (7,090) | (30.7%) | \$ (6,298) | (34.4%) |

Revenues. Total revenues increased \$4.8 million, or 26.3%, from \$18.3 million for the six months ended June 30, 2006 to \$23.1 million for the six months ended June 30, 2007. The increase in revenues was primarily due to an increase in unit sales, both domestically and internationally.

Cost of revenues. Cost of revenues increased \$1.4 million, from \$3.4 million for the six months ended June 30, 2006 to \$4.8 million for the six months ended June 30, 2007, primarily due to an increase in the total number of units sold. As a percentage of revenues, cost of revenues increased from 18.5% for the six months ended June 30, 2006 to 20.6% for the six months ended June 30, 2007. The increase in cost of revenues as a percentage of revenue was primarily due to an increase mix of revenues from new products which initially carry a higher product cost.

Research and development expenses. Research and development expenses increased \$0.2 million, from \$5.8 million for the six months ended June 30, 2006 to \$6.0 million for the six months ended June 30, 2007. The increase was primarily attributable to the hiring of additional full-time research and development personnel and the expansion of our research and development activities to increase our product offerings. Our product development activities included projects to extend and improve our Isolator® bipolar ablation system, develop our new Isolator Synergy ablation clamps and the Cosgrove-Gillinov Left Atrial Appendage Occlusion Clip, create new enabling devices and ablation tools and research new technologies. As a percentage of revenues, research and development expenses decreased from 31.9% for the six months ended June 30, 2006 to 26.2% for the six months ended June 30, 2007. We anticipate a continued increase in absolute dollars in research and development costs for the remainder of 2007 as a result of costs associated with the continued expansion of product development initiatives and clinical trials.

Selling, general and administrative expenses. Selling, general and administrative expenses increased \$4.3 million, from \$16.0 million for the six months ended June 30, 2006 to \$20.3 million for the six months ended June 30, 2007. The increase was primarily attributable to an increase in headcount-related charges primarily in the sales and marketing functions of \$2.0 million, an increase in marketing expenditures due primarily to increased marketing activities such as tradeshows of \$1.2 million, \$0.4 million related to a tentative settlement of an outstanding legal

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dispute with a former European distributor, and a \$0.4 million increase in stock option expense. As a percentage of total revenues, selling, general and administrative expenses increased from 87.4% for the six months ended June 30, 2006 to 88.0% for the six months ended June 30, 2007. Selling, general and administrative costs are expected to remain relatively consistent for the remainder of 2007.

Net interest income. Net interest income decreased \$0.2 million, from \$0.6 million for the six months ended June 30, 2006 to \$0.3 million for the six months ended June 30, 2007, due to the decrease in average cash, cash equivalents and investments outstanding.

Grant income. Grant income increased \$0.3 million, from \$0.1 million for the six months ended June 30, 2006 to \$0.4 million for the six months ended June 30, 2007 and consisted of income related to expense sharing under a grant for research and development related activities.

Foreign currency transaction gain. Foreign currency transaction gain was \$0.2 million for the three months ended June 30, 2007 and is related to the partial settlement of an intercompany account with AtriCure Europe B.V.

Liquidity and Capital Resources

On May 30, 2007, we completed a private placement of 1,789,649 shares of common stock, with gross proceeds to us of \$16.5 million. Of the total shares issued, 1,683,060 shares were issued to ten institutional investors at \$9.15 per share and 106,589 shares were issued to an entity affiliated with one of our directors at \$10.32 per share, the closing bid price on May 23, 2007. Net proceeds to us from the sale of the shares are expected to be approximately \$15.2 million after deducting transaction expenses. The net proceeds from the offering will be used for working capital and general purposes, including research and development activities and potential acquisitions or other strategic initiatives.

As of June 30, 2007, we had cash, cash equivalents and short-term investments of \$28.7 million and short-term and long-term debt of \$0.9 million, resulting in a net cash position of \$27.8 million. We had working capital of \$31.7 million and an accumulated deficit of \$63.1 million as of June 30, 2007.

Cash flows used in operating activities. Net cash used in operating activities was \$5.6 million for the six months ended June 30, 2007 and \$6.2 million for the six months ended June 30, 2006. Net cash used in operating activities for the six months ended June 30, 2007 was primarily attributable to the net loss of \$7.1 million and increases in accounts receivable and net inventory of approximately \$0.7 million and \$0.6 million, respectively, primarily due to an increase in revenues, partially offset by adjustments for depreciation and amortization of \$1.0 million, non-cash charges related to stock-based compensation of \$0.9 million, a net increase in payables and accrued liabilities of \$0.3 million due to our increase in operating expenses and inventory and a \$0.3 million increase in both other current assets and other non-current liabilities. Net cash used in operations for the six months ended June 30, 2006 was primarily attributable to a net loss of \$6.3 million and increases in accounts receivable and inventory of approximately \$0.7 million and \$0.9 million, respectively, each as revenue increased, partially offset by an increase in other current assets of approximately \$0.3 million, depreciation and amortization of approximately \$0.9 million and non-cash charges related to stock-based compensation of approximately \$0.5 million.

Cash flows provided by and used in investing activities. Net cash provided by investing activities was \$2.2 million for the six months ended June 30, 2007 and cash flows used in investing activities was \$1.3 million for the six months ended June 30, 2006. For each of these periods, cash flows provided by and used in investing activities reflected purchases of property and equipment of \$1.4 million and \$0.6 million for the six months ended June 30, 2007 and 2006, respectively, and, for the six months ended June 30, 2007, the net purchases and maturities of investments of \$3.6 million and, for the six months ended June 30, 2006, the net purchase of \$0.6 million of investments. During 2007, our expenditures for property and equipment primarily consisted of approximately \$0.3 million for the conversion of our manufacturing and development functions to our primary business system and approximately \$0.5 million in equipment associated with our Isolator Synergy product release.

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Cash flows provided by and used in financing activities. Net cash provided by financing activities was \$16.5 million for the six months ended June 30, 2007 and net cash used in financing activities was approximately \$145,000 for the six months ended June 30, 2006. For the six months ended June 30, 2007, cash flows provided by financing activities included \$16.5 million in gross proceeds from the May 2007 closing of our private placement of shares of our common shares and proceeds from exercises of stock options of approximately \$151,300, which were partially offset by payments made on our debt and lease obligations of approximately \$191,800. The net proceeds from the issuance of these shares are expected to be \$15.2 million. As of June 30, 2007, expenses related to the transaction were reflected as current liabilities. For the six months ended June 30, 2006, cash flows used in financing activities reflected payments made on our debt and lease obligations of approximately \$182,300 and were partially offset by proceeds from exercises of stock options of approximately \$37,600.

Credit facility. We entered into a \$5.0 million credit facility on March 8, 2005 with Lighthouse Capital Partners V, L.P. for working capital requirements. Outstanding borrowings under the facility bear interest at an annual rate of 8%. Our ability to draw down funds under this facility terminated upon our initial public offering. Under the terms of the facility, we are required to pay monthly installments of principal and interest, in addition to a fee due at maturity on September 1, 2009 equal to 15% of the aggregate amount borrowed under the credit facility, with prepayment in whole allowed at any time without penalty. As of June 30, 2007, there was \$0.9 million in borrowings outstanding under this facility.

In connection with establishing this facility, we granted Lighthouse a warrant to purchase 55,208 shares of our common stock, or shares into which such series of stock is converted, at a price of \$11.29 per share. The warrant expired unexercised on August 10, 2006. In addition, we granted Lighthouse a first perfected lien on all of our tangible and intangible assets, including accounts receivable, inventory, equipment, furniture and fixtures, but excluding intellectual property.

Uses of liquidity and capital resources. Our future capital requirements depend on a number of factors, including possible acquisitions and joint ventures, the rate of market acceptance of our current and future products, the resources we devote to developing and supporting our products, future expenses to expand and support our sales and marketing efforts, costs relating to changes in regulatory policies or laws that affect our operations and costs of filing, prosecuting, defending and enforcing our intellectual property rights. We expect to increase capital expenditures consistently with our anticipated growth in research and development, manufacturing, infrastructure and personnel.

We believe that our current cash and cash equivalents, along with the cash we expect to generate from operations, will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months. If these sources of cash are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or debt securities or obtain a credit facility. The sale of additional equity or convertible debt securities could result in dilution to our stockholders, such as our May 30, 2007 private placement transaction where we issued 1.8 million additional shares of our common stock. If additional funds are raised through the issuance of debt securities, these securities could have rights senior to those associated with our common stock and could contain covenants that would restrict our operations. Additional financing may not be available at all, or in amounts or terms acceptable to us. If we are unable to obtain this additional financing, we may be required to reduce the scope of our planned research and development and selling and marketing efforts.

Contractual Obligations and Commitments

In April 2007, we reached a tentative agreement to settle multiple disputes with Life Support Technology, LST b.v (LST), a former distributor of our products in Europe. As a result of the tentative settlement agreement, we agreed to pay LST 257,334 Euros, or approximately \$350,000, on an interest-free basis in quarterly installments over a four-year period, beginning in 2007. The present value of these payments, \$300,000, was accrued as of June 30, 2007.

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Off-Balance-Sheet Arrangements

As of June 30, 2007, we had operating lease agreements not recorded on the consolidated balance sheet. Operating leases are utilized in the normal course of business.

Inflation

Inflation has not had a significant impact on our historical operations and we do not expect it to have a significant impact on our results of operations or financial condition in the foreseeable future.

Seasonality

During the third quarter, we typically experience a sequential decline in revenues as compared to second quarter revenues. We attribute this primarily to the elective nature of the procedures in which our products are typically used, which we believe arises from fewer people choosing to undergo elective procedures during the summer months.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenue and expenses, and disclosures of contingent assets and liabilities at the date of the financial statements. On a periodic basis, we evaluate our estimates, including those related to accounts receivable, inventories and stock-based compensation. We use authoritative pronouncements, historical experience and other assumptions as the basis for making estimates. Actual results could differ from those estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements.

Stock-Based Compensation. On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004),

Share-Based Payment, (SFAS 123(R)), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options and employee stock purchases related to an employee stock purchase plan, based on estimated fair values. Employee stock-based compensation expense recognized under SFAS 123(R) for the three months ended June 30, 2007 and 2006 was \$250,905 and \$254,677, respectively and for the six months ended June 30, 2007 and 2006 was \$542,269 and \$423,583, respectively, on a before and after tax basis, which consisted of stock-based compensation expense related to employee stock options. See Note 8 to the Notes to Condensed Consolidated Financial Statements for additional information.

We estimate the fair value of options on the date of grant using the Black-Scholes option-pricing model. Our determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price, as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, our expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors. Due to our limited trading history, we used the implied volatility of a group of comparable companies. The weighted-average estimated fair value of options granted during the three and six months ended June 30, 2007 was \$4.88 and \$5.23, respectively and during the three and six months ended June 30, 2006 was \$3.98 and \$4.16, respectively, using the Black-Scholes model with the following assumptions:

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| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------------------------|-----------------------------|------------|---------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| Risk free interest rate | 4.56-5.07% | 1.00-5.14% | 4.56-5.07% | 1.00-5.14% |
| Expected life of option (years) | 6.0 | 6.0 | 6.0 | 6.0 |
| Expected volatility of stock | 44.00% | 38.06% | 44.00%-45.00% | 38.06% |
| Weighted-average volatility | 44.00% | 38.06% | 44.29% | 38.06% |
| Dividend yield | 0.00% | 0.00% | 0.00% | 0.00% |

The risk-free interest rate assumption is based upon the U.S. treasury yield curve at the time of grant for the expected option life. Due to our limited operating history, the expected lives are estimated based on other companies in our industry.

If factors change and we employ different assumptions in the application of SFAS 123(R) in future periods, the compensation expense that we record under SFAS 123(R) may differ significantly from what we have recorded in the current period.

Revenue Recognition. Revenues are generated primarily from the sale of our Isolator[®] bipolar ablation system. Pursuant to our standard terms of sale, revenue is recognized when title to the goods and risk of loss transfer to customers and there are no remaining obligations that will affect the customer's final acceptance of the sale. Generally, our standard terms of sale define the transfer of title and risk of loss to occur upon shipment to the respective customer. We maintain no post-shipment obligations to the recipients of the products. No installation, calibration or testing of this equipment is performed by us subsequent to shipment to the customer in order to render it operational. Product revenues include shipping revenues of approximately \$100,000 and \$61,000 for the three months ended June 30, 2007 and 2006, respectively and \$173,000 and \$105,000 for the six months ended June 30, 2007 and 2006. Cost of freight is included in cost of revenues. Sales taxes collected from customers and remitted to governmental authorities are excluded from product revenues. We sell our products through a direct and indirect sales force and through AtriCure Europe, B.V., our wholly-owned subsidiary incorporated in the Netherlands. Terms of sale are consistent for both end-users and distributors and payment terms are generally net 30 days. Customers and distributors generally have no right of return.

We comply with SEC Staff Accounting Bulletin No. 101, Recognition in Financial Statements, or SAB 101, as amended by SAB 104. SAB 101 sets forth guidelines on the timing of revenue recognition based upon factors such as passage of title, installation, payment terms and ability to return products. We recognize revenue when all of the following criteria are met: persuasive evidence that an arrangement exists, delivery of the products or services has occurred, the selling price is fixed or determinable, and collectibility is reasonably assured.

Sales Returns and Allowances. We maintain an allowance for sales returns and allowances as a result of defective or damaged products or when price reductions are given to customers. The allowance for sales returns and allowances is reviewed periodically and is adjusted on a specific identification basis. Increases to the allowance results in a reduction of revenue.

Allowance for Uncollectible Accounts Receivable. We systematically evaluate the collectibility of accounts receivable and determine the appropriate reserve for doubtful accounts. In determining the amount of the reserve, we consider aging of account balances, historical credit losses, other customer-specific information, and any other relevant factors or considerations. Increases to the allowance for doubtful accounts result in a corresponding expense. Periodically, we review accounts receivable and adjust the allowance based on current circumstances and charge off uncollectible receivables against the allowance when all attempts to collect the receivable have failed.

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Inventory Valuation. Inventories are stated at the lower of cost or market using the first-in, first-out, or FIFO, cost method and consist of raw materials, work in process and finished goods. Reserves are estimated for excess, slow-moving and obsolete inventory, as well as inventory with a carrying value in excess of its net realizable value. Write-offs are recorded when the product is destroyed. We review inventory on hand at least quarterly and record provisions for excess and obsolete inventory based on several factors, including current assessment of future product demand, anticipated release of new products into the market, historical experience and product expiration. Our industry is characterized by rapid product development and frequent new product introductions. Uncertain timing of product approvals, variability in product launch strategies, product recalls and variation in product utilization all impact the estimates related to excess and obsolete inventory.

Impairment of Long-Lived Assets. We, using our best estimates based on reasonable and supportable assumptions and projections, review for impairment our property and equipment and definite-lived intangible assets in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. We did not recognize any impairment of long-lived assets during the six months ended June 30, 2007 or 2006.

Deferred Tax Asset Valuation Allowance. Our estimate for the valuation allowance for deferred tax assets requires us to make significant estimates and judgments about our future operating results. Our ability to realize the deferred tax assets depends on our future taxable income, as well as limitations on their utilization. A deferred tax asset is reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized prior to its expiration. The projections of our operating results on which the establishment of a valuation allowance is based involve significant estimates regarding future demand for our products, competitive conditions, product development efforts, approvals of regulatory agencies, and product cost. If actual results differ from these projections, or if our expectations of future results change, it may be necessary to adjust the valuation allowance.

Recent Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140 (SFAS 155). SFAS 155 amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities and SFAS 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. The provisions of SFAS 155 are effective for financial instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of SFAS No. 155 in 2007 did not have a material impact on our financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which establishes a framework for measuring fair value and expands disclosures about fair value measurements. The provisions of SFAS 157 will be effective for us beginning January 1, 2008. We are in the process of determining the effect, if any, the adoption of SFAS 157 will have on our financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FASB Statement No. 115, which permits entities to measure many financial instruments and certain other items at fair value. The provisions of SFAS 159 will be effective for us beginning January 1, 2008. We are in the process of determining the effect, if any, the adoption of SFAS 159 will have on our financial statements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

We do not utilize derivative financial instruments, derivative commodity instruments or other market risk sensitive instruments, positions or transactions. We are exposed to various market risks, which include potential losses arising from adverse changes in market rates and prices, such as foreign exchange fluctuations and changes in interest rates.

For the six months ended June 30, 2007 and June 30, 2006, products sold by AtriCure Europe B.V. accounted for 6.7% and 5.2%, respectively, of our total revenues. Since such revenues were primarily denominated in Euros, we have exposure to exchange rate fluctuations between the Euro and the U.S. dollar. To date, the effect of the foreign exchange rate fluctuations on our financial results has not been material. For the six months ended June 30, 2007, we recorded foreign currency transaction gains of approximately \$204,000 in connection with partial settlement of an intercompany account with AtriCure Europe B.V.

For revenues denominated in Euros, if there is an increase in the rate at which Euros are exchanged for U.S. dollars, it will require more Euros to equal a specified amount of U.S. dollars than before the rate increase. In such cases, and if we price our products in Euros, we will receive less in U.S. dollars than we did before the rate increase went into effect. If we price our products in U.S. dollars and competitors price their products in Euros, an increase in the relative strength of the U.S. dollar could result in our price not being competitive in a market where business is transacted in Euros.

Although 93.3% of our revenues for the six months ended June 30, 2007 and 94.8% of our revenues for the six months ended June 30, 2006 were denominated in U.S. dollars, future fluctuations in the value of the U.S. dollar may affect the price competitiveness of our products outside the United States.

We invest our excess cash primarily in U.S. government securities, corporate bonds and commercial paper. Accordingly, we believe that, while the instruments we hold are subject to changes in the financial standing of the issuer of such securities, we are not subject to any material risks arising from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices or other market changes that affect market risk sensitive instruments.

Item 4. Controls and Procedures
Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report was carried out under the supervision and with the participation of our management, including our chief executive officer and chief financial officer. Based on that evaluation, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures are effective at the reasonable assurance level.

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Changes in Internal Control Over Financial Reporting

During the three months ended June 30, 2007, we converted our manufacturing and development functions to our primary business system. As we believe is the case in most system changes, the conversion of this system has necessitated minor changes to our operating procedures and the related internal controls and their method of application. However, throughout this conversion, there have been no changes in the Company's internal control over financial reporting 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 are not party to any material pending or threatened litigation, except as described below:

Class Action

We and certain of our current and former officers were named as defendants in a purported securities class action lawsuit filed in the United States District Court for the Southern District of New York (Levine v. AtriCure, Inc., Case No. 06 CV 14324 (United States District Court for the Southern District of New York)). The suit alleges violations of the federal securities laws and seeks damages on behalf of purchasers of our common stock during the period from our Initial Public Offering in August 2005 through February 16, 2006. We believe that the allegations are without merit and intend to vigorously defend against them, and our motion to dismiss this suit is currently pending.

Life Support Technology, LST b.v.

Multiple proceedings existed between Life Support Technology, LST b.v., a former distributor of our products in Europe, and us. In January 2006, LST filed an action against us in Den Bosch, Netherlands and in March 2006 we brought an action in Ohio against LST. These claims were tentatively settled in April 2007. As a result of the tentative settlement agreement, we agreed to pay LST 257,334 Euros, or approximately \$350,000, on an interest-free basis in quarterly installments over a four-year period, beginning in 2007. The present value of these payments, approximately \$300,000, was accrued as of June 30, 2007.

We may from time to time become a party to additional legal proceedings.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Form 10-K for the year ended December 31, 2006, all of which could materially affect our business, financial condition or future results. These described risks are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may adversely affect our business, financial condition and/or operating results.

In our Form 10-K for the year ended December 31, 2006, in Part I, Item 1A. Risk Factors, we disclosed in several risk factors that our Isolator bipolar ablation system did not have 510(k) clearance for the ablation of cardiac tissue or approval for the treatment of atrial fibrillation. On July 5, 2007, we received notification from the FDA that our Isolator® bipolar ablation clamp system received 510(k) clearance for the ablation of cardiac tissue. To date, none of our products have been approved for the treatment of atrial fibrillation.

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

(a) Unregistered Sales of Equity Securities and Use of Proceeds

On May 30, 2007, we completed a private placement of 1,789,649 shares of common stock with gross proceeds to us of \$16.5 million. This transaction was previously reported on our Current Report Form 8-K filed on May 25, 2007.

Table of Contents**(b) Initial Public Offering and Use of Proceeds from the Sale of Registered Securities**

We registered the initial public offering of our common stock, par value \$.001 per share, on a Registration Statement on Form S-1, as amended (Registration No. 333-124197), which was declared effective on August 4, 2005. On August 10, 2005, we consummated an initial public offering of 4.6 million shares of our common stock at \$12.00 per share, which includes the underwriters' exercise of their over-allotment option, on August 9, 2005, to purchase 600,000 shares of our common stock, of which 450,000 shares were sold by selling shareholders and 150,000 shares were sold by us. Gross proceeds to us from the offering were \$49.8 million. We did not receive any proceeds from the sale of the 450,000 shares of common stock that were sold by selling shareholders. Total expenses from the offering were \$6.6 million, which included underwriting discounts and commissions of \$3.5 million and \$3.1 million in other offering-related expenses. Proceeds to us from the offering after deducting underwriting discounts, commissions and offering expenses, were \$43.2 million.

Of the \$43.2 million in net proceeds from the initial public offering of our common, through June 30, 2007, we have spent \$6.4 million of these proceeds toward the acquisition of Enable Medical Corporation, \$5.0 million to acquire property and equipment and \$19.6 million was primarily spent to fund our business operations.

The use of proceeds does not represent a material change from the use of proceeds described in the prospectus relating to the Registration Statement. We have invested the remaining proceeds in a variety of capital preservation investments, including short-term, investment-grade, interest-bearing instruments.

No offering expenses were paid directly or indirectly to any of our directors or officers (or their associates) or persons owning ten percent or more of our equity securities or to any other affiliates except for payments made to Epstein, Becker & Green P.C., our corporate counsel, for legal fees and expenses incurred in connection with the offering. Theodore L. Polin, our corporate Secretary, is a shareholder of Epstein, Becker & Green P.C. Other than the exception described above, all offering expenses were paid directly to third parties who were not our directors or officers (or their associates), persons owning ten percent or more of our equity securities or any other affiliate.

(c) Repurchases of Equity Securities

None.

Item 4: Submission of Matters to a Vote of Security Holders

We held our Annual Meeting of Stockholders on June 20, 2007. The following is a brief description of each matter voted upon at the meeting and the number of votes cast for, withheld, or against, the number of abstentions and the number of broker non-votes with respect to each matter. The nine directors proposed by management for re-election were elected to new, one-year terms by the following vote:

| Director Name | Shares Voted For | Shares Withheld |
|---------------------------|-------------------------|------------------------|
| David J. Drachman | 9,430,339 | 5,345 |
| Donald C. Harrison, M.D. | 7,140,400 | 2,295,284 |
| Michael D. Hooven | 7,179,028 | 2,256,656 |
| Richard M. Johnston | 9,430,773 | 4,911 |
| Elizabeth D. Krell, Ph.D. | 9,431,573 | 4,111 |
| Mark R. Lanning, C.P.A. | 9,394,973 | 40,711 |
| Karen P. Robards | 7,142,228 | 2,293,456 |
| Lee R. Wrubel, M.D. | 7,142,228 | 2,293,456 |

The stockholders approved the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the year ending December 31, 2007: shares voted for: 9,391,479; shares voted against: 43,854; shares abstaining: 350; and broker non-votes: 0.

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Item 6. Exhibits

| Exhibit No. | Description |
|----------------------|--|
| 10.1 ^{(1)*} | Amendment of Employment Agreement, dated as of April 17, 2007, between AtriCure, Inc. and Julie A. Piton |
| 10.2 ⁽²⁾ | Securities Purchase Agreement, dated May 24, 2007, by and between AtriCure, Inc. and those purchasers executing the Securities Purchase Agreement. |
| 10.3 ⁽²⁾ | Registration Rights Agreement, dated May 24, 2007, by and between AtriCure, Inc. and those purchasers executing the Registration Rights Agreement. |
| 10.4 ⁽³⁾ | Bill of Sale and Assignment Agreement, dated as of August 7, 2007, between CooperSurgical, Inc. and AtriCure, Inc. |
| 10.5 ⁽³⁾ | Non-Competition Agreement, dated as of August 7, 2007, between CooperSurgical, Inc. and AtriCure, Inc. |
| 31.1 | Rule 13a-14(a) Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Rule 13a-14(a) Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification pursuant to 18 U.S.C. Section 1350 by the Chief Executive Officer, as adopted, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification pursuant to 18 U.S.C. Section 1350 by the Chief Financial Officer, as adopted, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

-
- (1) Incorporated by reference to our Current Report on Form 8-K, filed on April 20, 2007.
 (2) Incorporated by reference to our Current Report on Form 8-K, filed on May 25, 2007.
 (3) Incorporated by reference to our Current Report on Form 8-K, filed on August 9, 2007.
 * Compensatory plan or arrangement.

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SIGNATURES

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

AtriCure, Inc.
(REGISTRANT)

Date: August 14, 2007

/s/ David J. Drachman
David J. Drachman
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 14, 2007

/s/ Julie A. Piton
Julie A. Piton
Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

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