

SOLTA MEDICAL INC  
Form 10-Q  
August 03, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 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, 2011**

.. **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: 001-33123**

**SOLTA MEDICAL, INC.**

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

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)  
**68-0373593**  
(I.R.S. Employer  
Identification No.)  
**25881 Industrial Boulevard, Hayward, California 94545**  
(Address of principal executive offices) (Zip Code)  
**(510) 782-2286**  
(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 ☒ No ☐

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

Indicate by check mark whether the registrant is a Large accelerated filer, an accelerated filer, a non-accelerated filer or a small reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated Filer ☐ Accelerated filer ☐  
Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☒  
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of July 29, 2011, 60,762,273 shares of the registrant's common stock were outstanding.

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Thermage , ThermoCool , NXT , Reliant , Fraxel and Isolaz are registered trademarks in the United States and several other countries. All other trademarks, trade names and service marks appearing in this document are the property of their respective owners.

**Table of Contents****PART 1. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS (unaudited)****Solta Medical, Inc.****CONDENSED CONSOLIDATED BALANCE SHEETS***(in thousands of dollars, except share and per share data)***(Unaudited)**

	<b>June 30, 2011</b>	<b>December 31, 2010</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 37,108	\$ 36,898
Accounts receivable	13,219	12,426
Inventories	13,541	10,549
Prepaid expenses and other current assets	6,241	5,906
Total current assets	70,109	65,779
Property and equipment, net	5,349	6,227
Purchased intangible assets, net	34,624	36,809
Goodwill	49,481	49,481
Other assets	578	249
Total assets	\$ 160,141	\$ 158,545
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities:		
Accounts payable	\$ 7,379	\$ 6,358
Accrued liabilities	10,666	12,030
Current portion of deferred revenue	4,440	3,428
Short-term borrowings	8,874	9,528
Customer deposits	666	441
Total current liabilities	32,025	31,785
Deferred revenue, net of current portion	811	969
Term loan, net of current portion		98
Non-current tax liabilities	3,399	3,372
Other liabilities	137	177
Total liabilities	36,372	36,401
Contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, \$0.001 par value:		
10,000,000 shares authorized, none issued and outstanding		
Common stock, \$0.001 par value:		

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100,000,000 shares authorized, 60,743,211 and 59,728,410 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively.		
	61	60
Additional paid-in capital	196,053	193,198
Accumulated deficit	(72,345)	(71,114)
 Total stockholders' equity	 123,769	 122,144
 Total liabilities and stockholders' equity	 \$ 160,141	 \$ 158,545

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

**Table of Contents****Solta Medical, Inc.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS***(in thousands of dollars, except share and per share data)***(Unaudited)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Net revenue	\$ 28,954	\$ 30,080	\$ 55,405	\$ 56,015
Cost of revenue	10,391	11,358	18,781	20,500
Gross margin	18,563	18,722	36,624	35,515
<b>Operating expenses</b>				
Sales and marketing	11,915	11,429	23,733	21,317
Research and development	3,648	4,276	7,213	8,395
General and administrative	3,124	3,228	6,850	7,712
Litigation settlement gain		(2,241)		(2,213)
Total operating expenses	18,687	16,692	37,796	35,211
Income (loss) from operations	(124)	2,030	(1,172)	304
Interest income	19	11	33	18
Interest expense	(21)	(57)	(74)	(118)
Other income and expense, net	(9)	(228)	118	(317)
Income (loss) before income taxes	(135)	1,756	(1,095)	(113)
Provision for income taxes	71	247	136	311
Net income (loss)	\$ (206)	\$ 1,509	\$ (1,231)	\$ (424)
Net income (loss) per share:				
Basic	\$ (0.00)	\$ 0.03	\$ (0.02)	\$ (0.01)
Diluted	\$ (0.00)	\$ 0.02	\$ (0.02)	\$ (0.01)
Weighted average shares outstanding used in calculating net income (loss) per common share:				
Basic	60,634,849	59,437,038	60,269,804	58,229,078
Diluted	60,634,849	61,530,085	60,269,804	58,229,078

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



**Table of Contents****Solta Medical, Inc.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS***(in thousands of dollars)***(Unaudited)**

	<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Cash flows from operating activities</b>		
Net loss	\$ (1,231)	\$ (424)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	3,730	3,717
Loss on disposal of property, plant and equipment	41	3
Stock-based compensation	1,481	1,320
Tax expense from stock option exercises	9	10
Provision for doubtful accounts	(74)	190
Provision for excess and obsolete inventory	70	413
Change in assets and liabilities:		
Accounts receivable	(719)	2,010
Inventories	(3,072)	1,330
Prepaid expenses and other current assets	(336)	908
Other assets	(179)	226
Accounts payable	955	(50)
Accrued and other liabilities	(1,374)	(842)
Deferred revenue	704	(998)
Customer deposits	225	(15)
Deferred rent	(14)	(40)
Net cash provided by operating activities	216	7,758
<b>Cash flows from investing activities</b>		
Acquisition of property and equipment	(620)	(895)
Payments for acquisition, net of cash acquired		(232)
Net cash used in investing activities	(620)	(1,127)
<b>Cash flows from financing activities</b>		
Repayment of equipment leases		(27)
Repayment of loan agreement and short-term margin account borrowings	(16,752)	(16,706)
Cash settlement of vested restricted stock units		(140)
Proceeds from exercise of stock options	1,174	450
Proceeds from employee stock purchase plan	192	231
Proceeds from loan agreement borrowings	16,000	16,000
Proceeds from equity financing		17,230
Payment of equity financing issuance costs		(1,435)
Net cash provided by financing activities	614	15,603
Net increase in cash and cash equivalents	210	22,234
Cash and cash equivalents at beginning of period	36,898	14,744



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Cash and cash equivalents at end of period	\$ 37,108	\$ 36,978
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## **Supplemental disclosure of cash flow information**

Cash paid for interest	\$ 73	\$ 118
Cash paid for taxes	102	6

## **Supplemental disclosure of non-cash investing and financing activities**

Issuance of common stock for acquisition		4,750
Issuance of warrants in connection with equity financing		3,690
Accounts payable and accrued liabilities related to property and equipment purchases	144	326
Contingent consideration accrued in connection with Aesthera acquisition		157
Issuance of common stock for vested restricted stock units	132	359
Equity investment earned in the period	150	

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

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**Solta Medical, Inc.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

*(in thousands of dollars, except share and per share amounts)*

**(Unaudited)**

**NOTE 1 THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Background***

Solta Medical, Inc. (the Company) develops, manufactures, and markets aesthetic energy devices to address a range of skin issues brought on by the effects of aging, environmental factors or hormonal changes. The Company was incorporated in California on January 11, 1996 as Thermage, Inc. and reincorporated in Delaware on September 10, 2001. The Company commercially launched its first products in October 2002.

***Basis of Presentation***

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to state fairly the Company's financial position as of the date of the interim balance sheet and results of operations and cash flows for the interim periods. The results for the three and six months ended June 30, 2011 are not necessarily indicative of the results to be expected for the year ending December 31, 2011 or for any other interim period or for any future year.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes for the year ended December 31, 2010 included in the Company's Annual Report on Form 10-K.

***Significant Accounting Policies***

The Company's significant accounting policies that are disclosed in the Company's Annual Report on Form 10-K filed on March 16, 2011 have not changed since December 31, 2010, except the Company's *Revenue Recognition* policy (see note 3).

***Segment Information***

The Company operates in one business segment, which encompasses the developing, manufacturing and marketing of aesthetic energy devices. Management uses one measurement of profitability and does not segregate its business for internal reporting. All long-lived assets are maintained in the United States. The Chief Operating Decision Maker is the Chairman, President and Chief Executive Officer of the Company.

***Reclassifications***

To maintain comparability among the periods presented, the Company has reclassified the presentation of certain prior period amounts reported within interest income, interest expense and other income and expense presented in the accompanying Condensed Consolidated Statements of Operations. The reclassification had no impact to the total loss before income taxes in the periods presented.

***Correction to the June 30, 2010 Financial Statements***

Subsequent to the issuance of the June 30, 2010 condensed consolidated financial statements, management determined that fair value of the common stock warrants issued as part of the private placement financing in January 2010, previously reported as \$5,251 within the Condensed Consolidated Statement of Cash Flows was incorrectly computed and should have been reflected as \$3,690. The Company has corrected the amount within the supplemental disclosure of non-cash investing and financing activities in the accompanying Condensed Consolidated Statement of Cash Flows. This correction had no impact on operating, investing or financing cash flows or net loss for the period.



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The following table summarizes net revenue by product:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Systems	\$ 11,553	\$ 13,350	\$ 19,720	\$ 23,130
Tips and other consumables	15,831	14,396	32,608	28,543
Net revenue from products	27,384	27,746	52,328	51,673
Services and other	1,570	2,334	3,077	4,342
Total net revenue	\$ 28,954	\$ 30,080	\$ 55,405	\$ 56,015

The following table summarizes net revenue by geographic region:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
North America	\$ 13,426	14,465	\$ 24,267	25,962
Asia Pacific	9,594	9,651	18,128	17,256
Europe/Middle East	4,443	4,824	10,207	10,552
Rest of the world	1,491	1,140	2,802	2,245
Total net revenue	\$ 28,954	\$ 30,080	\$ 55,404	\$ 56,015

## NOTE 2 NET INCOME (LOSS) PER COMMON SHARE

Basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period.

Diluted net income (loss) per share attributed to common shares is computed by dividing the net income (loss) attributable to common shares for the period by the weighted average number of common and potential common shares outstanding during the period, if the effect of each class of potential common shares is dilutive. Potential common shares include common stock subject to repurchase rights and shares of common stock issuable upon the exercise of stock options and warrants and shares of common stock issuable under the Employee Stock Purchase Plan and restricted stock units. The dilutive effect of potential common shares is reflected in diluted net income (loss) per share by application of the treasury stock method, which includes consideration of stock-based compensation.

Diluted net loss per share is the same as basic net loss per share for certain periods presented because any potential dilutive common shares were anti-dilutive. Such potentially dilutive shares are excluded from the computation of diluted net loss per share when the effect would be to reduce net loss per share. Therefore, in periods when a loss is reported, the calculation of basic and diluted loss per share results in the same value.

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
<b>Historical net income (loss) per share:</b>				
Numerator:				
Net income (loss)	\$ (206)	\$ 1,509	\$ (1,231)	\$ (424)
Denominator:				
Weighted-average common shares outstanding used in calculating basic net income (loss) per share	60,634,849	59,437,038	60,269,804	58,229,078
Dilutive potential common shares used in calculated diluted net income per share		2,093,047		
Weighted-average common shares outstanding used in calculating diluted net income (loss) per share	60,634,849	61,530,085	60,269,804	58,229,078
Basic net income (loss) per share	\$ (0.00)	\$ 0.03	\$ (0.02)	\$ (0.01)
Diluted net income (loss) per share	\$ (0.00)	\$ 0.02	\$ (0.02)	\$ (0.01)

The following outstanding options, warrants, common stock issuable under the Employee Stock Purchase Plan and restricted stock units were excluded from the computation of diluted net loss per common share for the periods presented because including them would have had an antidilutive effect:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Options to purchase common stock	6,153,367	3,783,618	6,153,367	7,832,979
Common stock warrants	4,279,952		4,279,952	4,581,179
Restricted stock units	1,692,130		1,692,130	
Common stock issuable under Employee Stock Purchase Plan	111,992	117,565	111,992	117,565

**NOTE 3 ACCOUNTING POLICY REVENUE RECOGNITION****Revenue Recognition**

Product revenue is recognized when delivery has occurred, persuasive evidence of an arrangement exists, the price is fixed or determinable and collectability is reasonably assured. Delivery is deemed to have occurred when title and risks and rewards of ownership have transferred to the customer and remaining obligations are considered perfunctory. For most of the Company's product sales, transfer of title and risks and rewards of ownership occurs when the product is shipped. Revenue is recorded net of customer and distributor discounts and rebates. For sales transactions in which collectability is not reasonably assured, the Company recognizes revenue upon receipt of cash payment.

The Company sells to end-users in the United States and to distributors and end-users outside of the United States. Sales to end-users and distributors do not include return rights. The Company typically recognizes revenues upon shipment for sales through independent, third party distributors as the Company has no continuing obligations subsequent to shipment, other than replacement parts. The distributors are responsible for all marketing, sales, installation, training and warranty services for the Company's products, as well as obtaining regulatory clearances and approvals outside of the United States. While the regulatory approval process varies greatly by country and the Company may assist the distributor in the regulatory approval process, the responsibility belongs mainly to the distributor. The Company determines whether its remaining obligation in the sale is perfunctory prior to recording revenue. The Company does not provide price protection or stock rotation rights to any of its distributors. In addition, the Company's distributor agreements do not allow the distributor to return or exchange products and the distributor is obligated to pay the Company for the sale regardless of whether the distributor is able to resell the product.

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The Company also offers customers extended warranty service contracts. Revenue from the sale of extended service contracts is recognized on a straight-line basis over the period of the applicable extended contract. The Company also earns service revenue from customers outside of their warranty term or extended service contracts. Such service revenue is recognized as the services are provided.

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### ***Revenue Recognition for Arrangements with Multiple Deliverables***

In October 2009, the Financial Accounting Standards Board ( FASB ) issued ASU No. 2009-13, Multiple-Deliverable Revenue Arrangements ( ASU 2009-13 ), which amends Accounting Standards Codification ( ASC ) 605-25, Revenue Recognition Multiple Element Arrangements . ASU 2009-13 amended the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration based on the relative selling price of each deliverable. ASU 2009-13 permits prospective or retrospective adoption, and the Company elected prospective adoption during the first quarter of 2011. The adoption of ASU 2009-13 did not have a significant effect on the Company's revenue in the period of adoption.

The Company's products and services will generally continue to qualify as separate units of accounting under ASU 2009-13. The Company evaluates each deliverable in an arrangement to determine whether it represents a separate unit of accounting. A deliverable is considered a separate unit of accounting when it has stand-alone value to the customers and if the arrangement includes a customer refund or return right relative to the delivered item, the delivery and performance of the undelivered item is considered probable and substantially in the Company's control. In arrangements where the aforementioned criteria are not met, the deliverable is combined with the undelivered item(s) and revenue recognition is determined as one single unit.

The Company's multi-element arrangements generally consist of the sale of systems and post-sale obligations like training or installation. These obligations are fulfilled after product shipment. For multi-element arrangements like these, the Company allocates revenue to all deliverables based on their relative selling prices since the deliverables qualify as separate units of accounting. In such circumstances, ASU 2009-13 establishes a hierarchy to determine the selling price to be used for allocating revenue to deliverables as follows: (i) vendor-specific objective evidence of fair value ( VSOE ), (ii) third-party evidence of selling price ( TPE ), and (iii) best estimate of the selling price ( BEBP ). VSOE generally exists only when the Company sells the deliverable separately and is the price actually charged by the Company for that deliverable. BEBP reflects the Company's best estimate of what the selling price of that element would be if it was sold regularly on a stand-alone basis, considering factors relevant to its pricing practices such as standalone sales prices of similar products, customer type, and geography. Amounts allocated to the deliverables are recognized as revenue upon delivery, provided all other revenue recognition criteria have been satisfied.

## **NOTE 4 BALANCE SHEET DETAIL**

### ***Cash and Cash Equivalents***

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.

On a recurring basis, the Company measures its cash equivalents at fair value. Fair value is a market-based measurement that is determined based on assumptions that market participants would use in pricing an asset or liability. A fair value hierarchy prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value.

The Company's cash equivalents are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices for identical assets that the Company has the ability to assess at the measurement date. The Company's cash equivalents, which are money market funds that mature in three months or less, are classified as such at June 30, 2011 and December 31, 2010.

### ***Fair Value of Financial Instruments***

Carrying amounts of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, approximate their fair values due to their short maturities. Based on the borrowing rates available to the Company for loans with similar terms, the carrying value of the borrowings approximates their fair value. The carrying amounts of other assets and liabilities approximate their fair values based upon their nature and size.

**Table of Contents*****Inventories, Net***

Inventories, net consist of the following:

	June 30, 2011	December 31, 2010
Raw materials	\$ 4,578	\$ 4,458
Work-in-process	\$ 331	494
Finished goods	\$ 8,632	5,597
	\$ 13,541	\$ 10,549

***Intangible Assets***

The Company's intangible assets were acquired in connection with the acquisition of Reliant Technologies, Inc. on December 23, 2008, Aesthera Corporation on February 26, 2010 and CLRS Technology Corporation on October 15, 2010. The carrying amount and accumulated amortization expense of the acquired intangible assets at June 30, 2011 and December 31, 2010 were as follows:

June 30, 2011	Estimated Useful Life	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Intangible assets amortized to cost of revenue:				
Core technology	6 -12 years	\$ 21,320	(\$ 4,432)	\$ 16,888
Product technology	7 years	9,270	(3,340)	5,930
Future royalties contract	10 years	3,890		3,890
		34,480	(7,772)	26,708
Intangible assets amortized to operating expenses:				
Product development contract	1.9 years	620	(620)	
Non-compete agreement	2 years	500	(500)	
Trade Names	6 -10 years	3,980	(981)	2,999
Customer relationships	4 -12 years	6,310	(1,393)	4,917
		11,410	(3,494)	7,916
Total intangible assets		\$ 45,890	(\$ 11,266)	\$ 34,624



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<b>December 31, 2010</b>	<b>Estimated Useful Life</b>	<b>Gross Carrying Value</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Value</b>
Intangible assets amortized to cost of revenue:				
Core technology	6 -12 years	\$ 21,320	(\$ 3,423)	\$ 17,897
Product technology	7 years	9,270	(2,678)	6,592
Future royalties contract	10 years	3,890		3,890
		34,480	(6,101)	28,379
Intangible assets amortized to operating expenses:				
Product development contract	1.9 years	620	(669)	
Non-compete agreement	2 years	500	(505)	
Trade name	6 -10 years	3,980	(769)	3,211
Customer relationships	4 -12 years	6,310	(1,091)	5,219
		11,410	(3,034)	8,430
Total intangible assets		\$ 45,890	(\$ 9,135)	\$ 36,809

The Company has included amortization of acquired intangible assets directly attributable to revenue-generating activities in cost of revenue. The Company has included amortization of acquired intangible assets not directly related to revenue-generating activities in operating expenses. During the three and six months ended June 30, 2011, the Company recorded amortization expense in the amount of \$835 and \$1,671 to cost of revenue and \$284 and \$513 to operating expenses, respectively, and during the three and six months ended June 30, 2010, the Company recorded amortization expense in the amount of \$799 and \$1,546 to cost of revenue and \$411 and \$773 to operating expenses, respectively.

The Company has recorded an acquired intangible asset related to a future royalties contract that has not yet begun to generate revenue. The Company has deferred the amortization of the acquired intangible asset related to the future royalties contract until the asset begins to generate revenue.

As of June 30, 2011, the total expected future amortization related to intangible assets, is as follows:

	<b>Amortization included in Cost of Revenue</b>	<b>Amortization included in Operating Expense</b>	<b>Total Amortization Expense</b>
2011	\$ 1,672	\$ 568	\$ 2,240
2012	3,343	1,136	4,479
2013	3,343	1,136	4,479
2014	3,343	1,125	4,468
2015 and thereafter	15,007	3,951	18,958
	\$ 26,708	\$ 7,916	\$ 34,624

**Goodwill**

The changes in the carrying amount of goodwill are as follows:

	<b>June 30, 2011</b>	<b>December 31, 2010</b>
Balance at beginning of period	\$ 49,481	47,289
Addition from acquisition		2,192
Balance at end of period	\$ 49,481	\$ 49,481



**Table of Contents****Equity Method Investment**

The Company entered into an equity method investment in May 2011 with a privately held company and received approximately 12.5% of the fully diluted as-if converted outstanding capital stock of the investee, in exchange for entering into a Development and Supply Agreement with the Company. The Company will record the investment over the term of the agreement as a long-term other asset and deferred income in its consolidated balance sheet, and the Company will recognize the deferred income to earnings as it is earned over the term of the agreement. The fair value of the investment was determined based on a discounted cash-flow approach. The investment recorded during the three months ended June 30, 2011 is not material.

We may have the ability to exercise significant influence, but not control, over the investee, therefore the investment has been accounted for as an equity method investment. The Company records its share of the investee's results of operations within other income and expense, net, in the Company's consolidated statements of operations. Our share of the investee's results of operations is not material for the three and six months ended June 30, 2011.

**Accrued Liabilities**

Accrued liabilities consist of the following:

	June 30, 2011	December 31, 2010
Payroll and related expenses	\$ 4,443	\$ 4,436
Royalties payable	54	355
Warranty	1,471	1,525
Professional fees	388	510
Accrued purchases	197	397
Other	4,113	4,807
	\$ 10,666	\$ 12,030

**CLRS Contingent Consideration Liability**

On October 15, 2010, the Company acquired 100% of the common stock of CLRS Technology Corporation (CLRS), a privately held company. In connection with this transaction, the Company entered into a contingent consideration arrangement which may require payments if certain milestones related to revenue from the sale of CLRS products and operating income of CLRS are achieved during 2011. The fair value of the contingent consideration liability recognized on the acquisition date of \$878 was estimated by applying a probability weighted discounted cash-flow approach. As of June 30, 2011, the fair value of this contingent consideration liability has been reduced to \$394 to reflect our updated assessment of the probabilities assigned to achieving the revenue milestones and accordingly a \$484 gain was recognized in general and administrative expense in our condensed consolidated statement of operations during the three months ended June 30, 2011.

**NOTE 5 WARRANTY AND SERVICE CONTRACTS****Standard Warranty**

The Company currently accrues for the estimated cost to repair or replace products under warranty at the time of sale. A summary of standard warranty accrual activity is shown below:

	Six Months Ended June 30,	
	2011	2010
Balance at beginning of period	\$ 1,525	\$ 1,163
Additions from acquisition		240

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Accruals for warranties issued during the period	1,505	1,326
Settlements made during the period	(1,559)	(1,304)
Balance at end of period	\$ 1,471	\$ 1,425

**Table of Contents*****Extended Warranty Service Contracts***

The Company sells extended warranty service contracts to its customers. At the time of sale, the Company defers the amounts billed for such service contracts. Deferred service contract revenue, included as deferred revenue on the balance sheet, is recognized on a straight-line basis over the period of the applicable extended warranty contract. A summary of extended warranty contract activity is shown below:

	<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
Balance at beginning of period	\$ 2,805	\$ 2,440
Additions from acquisition		302
Payments received	2,112	1,593
Revenue recognized	(1,960)	(1,981)
Balance at end of period	\$ 2,957	\$ 2,354

As of June 30, 2011, \$2,146 of the extended warranty contracts was classified as current and \$811 was classified as non-current. The Company incurred costs of \$369 and \$694 under extended warranty contracts during the three and six months ended June 30, 2011, respectively, and costs of \$241 and \$486 during the three and six months ended June 30, 2010, respectively.

**NOTE 6 CREDIT FACILITY**

The Company entered into a Loan and Security Agreement (the "Loan Agreement") with Silicon Valley Bank (the "Lender") on March 9, 2009 with a subsequent amendment on March 27, 2009, providing for a \$6,000 secured revolving loan facility, with availability to be subject to a borrowing base formula, and a \$3,000 secured term loan. On June 30, 2009, the Company entered into a second amendment to the Loan Agreement which provided for an increase of the secured revolving loan facility to \$8,000 and an additional \$1,000 secured term loan. On March 31, 2010, the Company entered into a third amendment to the Loan Agreement which provided for an increase of the commitment under the loan facility by adding a \$10 million secured term loan facility, amended the financial covenants, which includes changes to the liquidity ratio, minimum EBITDA covenant and removal of the tangible net worth covenant, and extended the maturity date of the existing revolving loan facility from March 9, 2011 to March 8, 2012. On October 15, 2010, the Company entered into a fourth amendment to the Loan Agreement, which authorized the Company to consummate the acquisition of CLRS. On April 20, 2011, the Company entered into a fifth amendment to the Loan Agreement, which extended the borrowing period for term loans borrowed under the secured term loan facility from March 31, 2011 to March 31, 2012, and extended the maturity date of such borrowings from December 31, 2013 to December 31, 2014. Other terms of the Loan Agreement remain unchanged. At June 30, 2011, \$8,000 was outstanding on the revolving loan facility and \$874 was outstanding on the secured term loans.

As of June 30, 2011, the Loan Agreement contains financial covenants requiring the Company to maintain a minimum liquidity ratio and minimum EBITDA. The Company was in compliance with these covenants as of June 30, 2011. The Company repaid all funds drawn from the revolving loan facility in July 2011.

**NOTE 7 CONTINGENCIES*****Litigation Matters***

From time to time, the Company is involved in litigation relating to claims arising from the ordinary course of business. The Company routinely assess the likelihood of any adverse judgments or outcomes related to legal matters and claims, including those involving its intellectual property protection, as well as ranges of probable losses. A determination of the amount of the reserves required, if any, for these contingencies is made after thoughtful analysis of each known issue and an analysis of historical experience. The Company does not believe the final disposition of these matters will have a material adverse effect on the financial statements and future cash flows of the Company. All legal expenses, including those related to intellectual property protection, are expensed as they are incurred. Also, the Company does not record any gain contingencies.

On December 21, 2009, a complaint was filed in the Santa Clara County Superior Court by three former stockholders of Reliant against Reliant and certain former officers and directors of Reliant in connection with the Company's acquisition of Reliant, which closed on December 23, 2008. The complaint purports to be brought on behalf of the former common stockholders of Reliant. As a result of the acquisition, a successor

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entity to Reliant, Reliant Technologies, LLC, became the Company's wholly-owned subsidiary. One member of the Company's Board of Directors and the Company's former Chief Technology Officer and former

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member of the Company's Board of Directors are among the defendants named in the complaint. The principal claim, among others, is that Reliant violated the California Corporations Code by failing to obtain the vote from a majority of holders of Reliant's common stock prior to the consummation of the acquisition. The complaint also purports to challenge disclosures made by Reliant in connection with its entry into the acquisition and alleges that the defendants failed to maximize the value of Reliant for the benefits of Reliant's common stockholders. On August 2, 2010, defendants filed a motion to dismiss or stay the entire action based on a mandatory forum selection clause in the merger agreement which requires that claims related to the merger be litigated in Delaware. On September 28, 2010, the Court granted the defendants motion to dismiss or stay, and stayed the action indefinitely. To date, the plaintiffs have not filed a complaint against the defendants in Delaware. The Company believes that this suit is without merit, and the Company intends to vigorously defend it. Although the Company does not expect that the final disposition of this litigation will have a material adverse effect on its financial results, the Company expects to devote certain personnel and resources to resolve this litigation.

On December 4, 2009, Aesthera was served with a class action complaint filed in the United States District Court for the District of Connecticut alleging that Aesthera caused unsolicited fax advertisements to be sent to the plaintiffs in violation of the Telephone Consumer Protection Act, or TCPA, and Connecticut state law. The complaint purports to be filed on behalf of a class, and it alleges that Aesthera caused unsolicited fax advertisements to be sent from August 1, 2006 through the present. Plaintiffs seek statutory damages under the TCPA and Connecticut state law, attorneys' fees and costs of the action, and an injunction to prevent any future violations. In May 2010, the Company reached an agreement in principle to settle the matter on a class-wide basis by consenting to certification of a settlement class to receive payment out of a settlement fund. On November 5, 2010, the plaintiffs filed an unopposed motion for certification of a settlement class and for preliminary approval of the parties' settlement. Discovery in this action has been stayed since May 6, 2010, and on December 9, 2010, the Court extended that stay until March 9, 2011 so as to permit itself an opportunity to review and rule upon [plaintiffs'] pending motion. On April 15, 2011, the Court denied plaintiffs' motion without prejudice on the grounds that the proposed means of giving notice to the class i.e., via fax was not adequate. The Court directed the plaintiffs to revise their motion to provide for notice to the class via United States mail. The Court further directed that the cost of this notice should be borne by Aesthera without reduction to the amount of the settlement fund. If the process does not result in approval of a settlement, then the Company anticipates that the parties will engage in discovery and that Aesthera will vigorously oppose certification of a class. The Company believes that it has meritorious defenses in this action and intend to defend the action vigorously if the proposed settlement is not approved by the Court. The Company does not believe the final disposition of this action will have a material adverse effect on its financial statements and future cash flows.

In January 2008, a product design complaint was filed against the Company in Federal District Court in Maryland. The individual seeks monetary damages, a portion of which the Company believes is within our insurance limits, as well as attorney's fees and costs of the action. Discovery in the matter is essentially complete and the trial date has been set for September 2011. The Company does not believe the final disposition of this action will have a material adverse effect on its operating results, financial condition or future cash flows. The Company believes that it has meritorious defenses in this action and intend to continue to defend the action vigorously.

### ***Indemnifications***

In the normal course of business, the Company enters into contracts and agreements that contain a variety of representations and warranties and provide for general indemnifications. The Company's exposure under these agreements is unknown because it involves claims that may be made against the Company in the future, but have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to its indemnification obligations. However, the Company may record charges in the future as a result of these indemnification obligations.

In accordance with its certificate of incorporation, bylaws and individual indemnification agreements, the Company has indemnification obligations to its officers and directors and certain key employees for certain events or occurrences, subject to certain limits, while they are serving at the Company's request in such a capacity. There have been no claims to date and the Company has a director and officer insurance policy that may enable it to recover a portion of any amount paid for future claims.

### **NOTE 8 STOCK-BASED COMPENSATION**

Stock-based compensation expense is recognized using a fair-value based method for costs related to all share-based payments related to stock options granted to employees and non-employees, the Employee Stock Purchase Plan and restricted stock unit awards. The stock-based compensation expenses are allocated to cost of revenue, sales and marketing, research and development and general and administrative as follows:

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	Three Months ended June 30,		Six Months ended June 30,	
	2011	2010	2011	2010
<b>Stock-based compensation expense:</b>				
Employee stock-based compensation expense	\$ 371	\$ 568	\$ 774	\$ 1,130
Employee stock purchase plan	389	52	85	110
Restricted stock units	52	(2)	622	80
<b>Total stock-based compensation expense</b>	<b>\$ 812</b>	<b>\$ 618</b>	<b>\$ 1,481</b>	<b>\$ 1,320</b>

	Three Months ended June 30,		Six Months ended June 30,	
	2011	2010	2011	2010
Cost of revenue	\$ 95	\$ 68	\$ 164	\$ 142
Sales and marketing	193	183	419	398
Research and development	95	85	142	130
General and administrative	429	282	756	650
<b>Total stock-based compensation expense</b>	<b>\$ 812</b>	<b>\$ 618</b>	<b>\$ 1,481</b>	<b>\$ 1,320</b>

During the six months ended June 30, 2010, the board of directors approved the issuance of 918,950 shares of restricted stock units to certain employees under the 2006 Equity Incentive Plan. The value of the restricted stock awards was based on the closing stock market price on the award date. Out of the total restricted stock units granted in 2010, 731,000 of the awards would be subject to vesting over three years if such units are earned by the achievement of certain corporate performance-based milestones. As of December 31, 2010, these milestones were not achieved and accordingly the respective stock awards expired during the quarter ended March 31, 2011. As a result, no stock based compensation expense was recognized for these awards. The remaining 187,950 restricted stock units granted in the first six months of 2010 continue to vest over three years.

During the six months ended June 30, 2011, under the 2006 Equity Incentive Plan, the board of directors approved the issuance of 1,142,330 shares of restricted stock units and 733,300 shares of market stock units to certain employees. The value of the restricted stock awards was based on the closing stock market price on the date of award. These restricted stock units vest over three years. The fair value of the market stock units at the issuance date was estimated using the Monte-Carlo simulation model which is a probabilistic approach for calculating the fair value of the awards. The Monte-Carlo simulation is a statistical technique used, in this instance, to simulate future stock prices of the Company and the Russell Microcap Index by using the following assumptions: expected volatility of 82.92% and 35.29%, correlation coefficients of 1.0 and 0.2183, risk-free interest rate of 1.4%, and contractual life of 3 years. The market stock units will vest over three years if certain market conditions are met. The market conditions are tied to the performance of the Company's common stock relative to the Russell Microcap Index.



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

*This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws. These statements include, but are not limited to, introduction of new procedures and associated treatment tips in the future; sales organization growth; growth in international sales and expansion into new international markets; and our belief that our cash, cash equivalents and marketable investments, along with our credit facility will satisfy our anticipated cash requirements. These statements are subject to risks and uncertainties that could cause actual results and events to differ materially from those expressed or implied by such forward-looking statements. For a detailed discussion of these risks and uncertainties, see Risk Factors section in Item 1A of this Quarterly Report on Form 10-Q. We caution the reader not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of this Form 10-Q. We undertake no obligation to update forward-looking statements, which reflect events or circumstances occurring after the date of this Form 10-Q. We also encourage you to read the Critical Accounting Policies in Item 7 Management's Discussion and Analysis contained in Part II of our Annual Report on Form 10-K filed on March 16, 2011.*

#### **Overview**

We design, develop, manufacture and market aesthetic energy devices to address a range of skin conditions brought on by the effects of aging, environmental factors or hormonal changes. Our products are patented and generally require FDA clearance and the CE Mark prior to marketing. The product technologies we use include radiofrequency, or RF, energy, to heat and shrink collagen and tighten tissue while simultaneously cooling and protecting the surface of the skin; lasers for skin resurfacing and the treatment of actinic keratosis; and intense pulsed light, IPL, for the treatment of mild to moderate acne and other dermatologic conditions.

We were incorporated in 1996 and received FDA clearance for our first Thermage RF system in 2002. Through a number of acquisitions, we added the Fraxel laser systems from Reliant Technologies in December 2008; the Isolaz (IPL) system from Aesthera Corporation in February 2010; and the Claro (IPL) personal care acne treatment device from CLRS in October 2010. Our latest product introduction is the CLEAR + BRILLIANT laser system, for which we received FDA clearance in May 2011.

As of June 30, 2011, we had a global installed base of over 7,400 systems.

Net revenue for the six months ended June 30, 2011 decreased 1% or \$0.6 million, to \$55.4 million, from \$56.0 million in the same period in 2010, mainly from a decline in system upgrades, a decrease in system sales and handpiece sales, and a decrease in research and development revenue due to a research contract having ended in 2010, partially offset by higher tip revenue and contributions from the sale of the new CLEAR + BRILLIANT products which launched in April 2011. Our business continued to be impacted by the weakness in global economic conditions and tight credit markets, which we believe have continued to contribute to a slowdown in customer purchase decisions. The tight credit markets limited the ability of some of our customers to obtain financing for the purchase of our products. In response to the continuing difficulties in the economy, we have implemented a number of initiatives in response to the tight worldwide credit market, including expanding our partner program to include Fraxel consumables as well as offering incentives to doctors who become Fraxel, Thermage and Isolaz customers.

#### **Significant Business Trends**

We derive revenue primarily from the sale of systems, treatment tips and consumables. For the six months ended June 30, 2011 and 2010, we derived 59% and 51% respectively, of our revenue from treatment tips and consumable sales, and 36% and 41% respectively, of our revenue from system sales. The balance of our revenue is derived from service, research and development and shipping.

During the first half of 2011, sales of treatment tips and consumables increased as a percentage of our revenue versus system sales, as compared to the same percentage in the first half of 2010, due to the acquisition of Aesthera and a decline in system upgrades.

We market our professional products in North America to physicians, primarily dermatologists and plastic surgeons, through a direct sales force and internationally through a network of independent distributors and our direct sales force in certain countries. Distribution of our consumer product is through retail channels and our own web site and this product is currently only available in the United States. In the six months ended June 30, 2011 and 2010, we derived 44% and 46%, respectively, of our revenue from sales of our products and services within North America, and 56% and 54%, respectively, of our total sales outside of North America. We believe that a significant portion of our business will continue to come from international sales through increased penetration in countries where we currently sell our products, combined with expansion into new international markets. The percentages of our revenue by region are presented in the table below:



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	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
North America	46%	48%	44%	46%
Asia Pacific	33%	32%	33%	31%
Europe/Middle East	15%	16%	18%	19%
Rest of the world	6%	4%	5%	4%
Total net revenue	100%	100%	100%	100%

Future operating results are difficult to predict accurately. We anticipate that our quarterly results of operations may fluctuate for the foreseeable future due to several factors, including prevailing economic conditions and our customers' access to credit, the timing of introduction and the degree of acceptance of future product offerings, unanticipated interruptions and expenses related to our manufacturing operations, and the performance of our direct sales force and international distributors.

As new or enhanced products are introduced, we must successfully manage the transition from older products in order to minimize disruption in customers' ordering patterns, avoid excessive levels of older product inventories, and ensure that enough supplies of new products can be delivered to meet customer demand.

**Significant Industry Factors**

Our business is subject to the impact of economic conditions on the growth of the industry and to our ability to continue to develop new products, applications and innovative technologies, obtain and maintain regulatory clearances for our products, protect our proprietary technology, and successfully market and distribute our products. Our industry is characterized by seasonally lower demand during the third calendar quarter of the year, when both physicians and prospective patients take summer vacations. Additionally, our industry is highly competitive and our success depends on our ability to compete successfully. Our business is sensitive to a number of factors that influence the levels of consumer spending, including political and economic conditions such as recessionary environments, the level of disposable consumer income, consumer debt, interest rates and consumer confidence. Declines in consumer spending on aesthetic procedures could have an adverse effect on our operating results. A detailed discussion of these and other factors that impact our business is provided in the Risk Factors section in this Quarterly Report on Form 10-Q.

**Results of Operations*****Three and Six Months Ended June 30, 2011 and 2010***

**Net Revenue.** Revenue is derived from the sales of systems, treatment tips and other consumables, and service and other revenue. Net revenue was \$29.0 million for the three months ended June 30, 2011, a decrease of \$1.1 million, or 4%, compared to \$30.1 million for the three months ended June 30, 2010. This decrease in net revenue is primarily due to a decrease in system upgrades, a decrease in handpiece sales, and a decrease in research and development revenue due to a research contract having ended in 2010, partially offset by higher tip revenue, an increase in new system sales including contributions from the sale of the new CLEAR + BRILLIANT products which launched in April 2011. System sales for the three months ended June 30, 2011 was \$11.6 million, a decrease of \$1.8 million, or 13%, compared to \$13.4 million for the same period in 2010. Sales of treatment tips and other consumables was \$15.8 million, an increase of \$1.4 million, or 10%, compared to \$14.4 million for the same period in 2010.

Net Revenue decreased \$0.6 million, or 1%, to \$55.4 million from \$56.0 million for the six months ended June 30, 2011 and 2010, respectively. This decrease was primarily due to a decline in system upgrades, a decrease in system sales and handpiece sales, and a decrease in research and development revenue due to a research contract having ended in 2010, partially offset by higher tip revenue and contributions from the sale of the new CLEAR + BRILLIANT products. System sales decreased \$3.4 million or 15%, to \$19.7 million from \$23.1 million for the six months ended June 30, 2011 and 2010, respectively. Sale of treatment tips and other consumables increased by \$4.1 million or 14%, to \$32.6 million from \$28.5 million for the six months ended June 30, 2011 and 2010, respectively.

**Cost of Revenue.** Our cost of revenue consists primarily of material, labor and manufacturing overhead expenses. Gross margin was 64% of revenue for the three months ended June 30, 2011, compared with 62% of revenue for the same period in 2010. The increase in gross margin as a percent of revenue for the second quarter in 2011 when compared to the prior year period was primarily due to our sales for the quarter consisting of a relatively higher mix of tip sales, and lower product excess and obsolescence costs.

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Gross margin was 66% of revenue in the first half of 2011, compared with 63% of revenue in the first half of 2010. The increase in gross margin as a percent of revenue for the first half of 2011 when compared to the prior year period was primarily due to a higher mix of tip sales, and lower product excess and obsolescence costs.

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***Sales and Marketing.*** Sales and marketing expenses consists primarily of personnel costs and costs related to customer-attended workshops and trade shows and advertising, as well as marketing and customer service expenses. Sales and marketing expenses for the three months ended June 30, 2011 was \$11.9 million, an increase of \$0.5 million, or 4%, compared to \$11.4 million for the same period in 2010. The increase was primarily attributable to an increase of \$0.3 million in employee payroll and related travel and entertainment expenses, an increase of \$0.1 million in discretionary marketing expenses, and an increase of \$0.3 million in professional outside services, offset by a decrease of \$0.2 million in telecommunication, depreciation and allocated information technology and facility expenses.

Sales and marketing expenses increased \$2.4 million, or 11%, to \$23.7 million from \$21.3 million in the first half of 2011 and 2010, respectively. The increase in the first half of 2011 was primarily attributable to an increase of \$1.4 million in employee payroll and related travel and entertainment expenses, an increase of \$0.4 million in discretionary marketing expenses, an increase of \$0.5 million in professional outside services, and an increase of \$0.1 million in amortization of intangibles.

***Research and Development.*** Research and development expenses consists primarily of personnel costs, clinical and regulatory costs, material costs and regulatory and quality assurance costs not directly related to the manufacturing of our products. Research and development expenses for the three months ended June 30, 2011 was \$3.6 million, a decrease of \$0.6 million, or 15%, compared to \$4.3 million for the same period in 2010. The decrease was mainly due to a decrease of \$0.1 million in employee payroll and related personnel expenses, a decrease of \$0.2 million in amortization of intangibles, a decrease of \$0.2 million in clinical studies and other research and development project costs, and a decrease of \$0.1 million in telecommunication, depreciation and allocated information technology and facility expenses.

Research and development expenses decreased \$1.2 million, or 14% to \$7.2 million from \$8.4 million in the first half of 2011 and 2010, respectively. Compared to the first half of 2010, employee payroll and related expenses decreased by \$0.8 million, clinical studies and other research and development projects decreased by \$0.4 million, and amortization of intangibles decreased by \$0.3 million, partially offset by an increase of \$0.3 million in clinical studies and other research and development project costs.

***General and Administrative.*** General and administrative expenses consists primarily of personnel costs, legal and accounting fees, human resources costs and other general operating expenses. General and administrative expenses for the three months ended June 30, 2011 was \$3.1, a decrease of \$0.1 million, or 3%, compared to \$3.2 million for the same period in 2010. The decrease was primarily due to a decrease of \$0.1 million in employee payroll and related personnel expenses, and a credit of \$0.5 million resulting from the reversal of contingent consideration associated with the acquisition of CLRS, partially offset by an increase of \$0.2 million in professional outside services, an increase of \$0.2 million in sales and use taxes, and an increase of \$0.1 million in telecommunication, depreciation and allocated information technology and facility expenses.

General and administrative expenses in the first half of 2011 was \$6.9 million, a decrease of \$0.8 million or 11%, compared with \$7.7 million in the first half of 2010. The decrease from the prior year period was due to a decrease of \$0.8 million in acquisition related expenses, a decrease of \$0.3 million in employee payroll and related expenses, and a credit of \$0.5 million resulting from the reversal of contingent consideration associated with the acquisition of CLRS, partially offset by an increase of \$0.2 million in product liability claims, an increase of \$0.2 million in professional outside services, an increase of \$0.2 million in sales and use taxes and an increase of \$0.2 million in business insurance.

***Litigation Settlement.*** In May 2010, we settled patent-related litigation claims between us and a third party. Under this agreement, the parties granted each other a covenant not to sue under the patents in the suit and related patents. We received a one-time cash payment of \$2.3 million and incurred external legal expense of \$9,000 and \$37,000 for the three and six months ended June 30, 2010, respectively. This resulted in a net litigation settlement gain of \$2.24 million and \$2.21 million in our statement of operations for the three and six months ended June 30, 2010, respectively.

***Interest Income.*** Interest income consists primarily of interest income generated from our cash and cash equivalents. Interest income increased \$8,000, or 73%, to \$19,000 for the three months ended June 30, 2011 from \$11,000 for the same period in 2010, and increased \$15,000, or 83%, to \$33,000 for the six months ended June 30, 2011 from \$18,000 for the same period in 2010. The increase is primarily due to higher average cash and cash equivalent balances during the first half of 2011.

***Interest Expense.*** Interest expense consists primarily of interest expense resulting from borrowings on the line of credit and term loans. Interest expense decreased by \$36,000, or 63%, to \$21,000 for the three months ended June 30, 2011 from \$57,000 for the same period in 2010, and decreased by \$44,000, or 37%, to \$74,000 for the three months ended June 30, 2011 from \$118,000 for the same period in 2010. The decrease is a result of lower debt balances during the first half of 2011.

***Other Income and Expense, net.*** Net other income and expense consists primarily of activity resulting from foreign exchange gains and losses and activity from our equity investment. Net other income and expense was net expense of \$9,000 and net expense of \$228,000 in the three

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months ended June 30, 2011 and 2010, respectively, and net income of \$118,000 and net expense of \$317,000 in the six months ended June 30, 2011 and 2010, respectively. The net expense decrease in the first quarter and half of 2011 when compared to the same periods in the prior year is primarily due to foreign exchange gains resulting from currency fluctuations during the first quarter and half of 2011.

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*Provision for Income Taxes.* There was an income tax provision of \$71,000 and \$247,000 for the three months ended June 30, 2011 and 2010, respectively, and \$136,000 and \$311,000 for the six months ended June 30, 2011 and 2010, respectively. The provision for income taxes for the second quarter and first half of 2011 and 2010 primarily represents taxes in foreign and state jurisdictions.

**Stock-Based Compensation**

For the three and six months ended June 30, 2011 and 2010 employee and non-employee stock-based compensation expense has been allocated as follows (in thousands):

	Three Months ended June 30,		Six Months ended June 30,	
	2011	2010	2011	2010
Cost of revenue	\$ 95	\$ 68	\$ 164	\$ 142
Sales and marketing	193	183	419	398
Research and development	95	85	142	130
General and administrative	429	282	756	650
Total stock-based compensation expense	\$ 812	\$ 618	\$ 1,481	\$ 1,320

**Reconciliation of GAAP to Non-GAAP Financial Measures**

The following presentation includes non-GAAP measures. Our non-GAAP measures are not meant to be considered in isolation or as a substitute for comparable GAAP measures. The Company believes that non-GAAP measures have limitations in that they do not reflect all of the amounts associated with the Company's results of operation as determined in accordance with GAAP and that these measures should only be used to evaluate the Company's results of operations in conjunction with the corresponding GAAP measures.

The non-GAAP financial measures presented are non-GAAP gross margin, non-GAAP gross margin as a % of sales, non-GAAP operating income, non-GAAP EBITDA, non-GAAP net income and non-GAAP net income per share. These non-GAAP financial measures, as defined by us, are adjusted to exclude one or more of the following items: in process research and development, amortization of acquired intangibles and other non-cash acquisition-related charges, severance expense, acquisition-related expenses, loss on investments and stock-based compensation expense.

We use non-GAAP financial measures as performance measures to supplement the financial information we present on a GAAP basis. We believe these non-GAAP financial measures provide useful information to investors and management for the reasons stated below.

Non-GAAP gross margin and non-GAAP gross margin as a % of sales provide useful information to investors regarding the Company's gross margin by excluding from cost of sales non-cash items like amortization of acquisition related intangibles and stock-based compensation expenses. These costs are generally fixed at the time of acquisition or when the stock-based award is granted, are then expensed or amortized over several years and generally cannot be changed or influenced by management after acquisition or once granted. We further believe that excluding these charges can provide useful information to investors for the reasons stated in the footnotes to these respective items in the presentation that follows.

Non-GAAP operating income reflects our ongoing business in a manner that allows for meaningful period-to-period comparison and analysis of trends in our business, as they exclude expenses that may not be regarded as reflective of ongoing operating results like severance expenses and acquisition related in-process research and development expenses, as well as those discussed in non-GAAP gross margin above. We further believe that excluding the identified expenses can provide useful information to investors for the reasons stated in the footnotes to these respective items in the presentation that follows.

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Non-GAAP EBITDA enables investors to assess the Company's compliance with financial covenants under its debt instruments. Our credit facility loans have financial covenants that use non-GAAP EBITDA as part of the measure.

Non-GAAP net income and non-GAAP net income per share, by excluding non-cash and one-time expenses like those discussed in non-GAAP gross margin and non-GAAP operating income measures above, provide useful information to investors and others in understanding and evaluating our financial results and future prospects in the same manner as management and in comparing financial results across accounting periods.



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For a detailed explanation of the adjustments made to comparable GAAP measures and the reasons why management uses these adjustments, see items (1) – (7) below.

	Three Months Ended		Six Months Ended	
	June 30, 2011	2010	June 30, 2011	2010
GAAP Gross margin	\$ 18,563	\$ 18,722	\$ 36,624	\$ 35,515
GAAP gross margin as % of sales	64%	62%	66%	63%
Non-GAAP adjustments to gross margin:				
GAAP Gross margin	\$ 18,563	\$ 18,722	\$ 36,624	\$ 35,515
Amortization and other non-cash acquisition related charges (1)	844	1,142	1,689	2,002
Stock-based compensation (4)	95	68	164	142
Non-GAAP gross margin	\$ 19,502	\$ 19,932	\$ 38,477	\$ 37,659
Non-GAAP gross margin as % of sales	67%	66%	69%	67%
GAAP income (loss) from operations	(\$ 124)	\$ 2,030	(\$ 1,172)	\$ 304
Non-GAAP adjustments to net income (loss) from operations:				
Amortization and other non-cash acquisition related charges (1)	644	1,430	1,718	2,651
Severance expenses (2)		55		55
Acquisition-related expenses (3)	120	139	120	963
Stock-based compensation (4)	812	618	1,481	1,320
Non-GAAP income from operations	\$ 1,452	\$ 4,272	\$ 2,147	\$ 5,293
Depreciation expenses (5)	763	742	1,545	1,398
Non-GAAP EBITDA	\$ 2,215	\$ 5,014	\$ 3,692	\$ 6,691
GAAP net income (loss)	(\$ 204)	\$ 1,509	(\$ 1,231)	(\$ 424)
Non-GAAP adjustments to net income (loss):				
Amortization and other non-cash acquisition related charges (1)	644	1,430	1,718	2,651
Severance expenses (2)		55		55
Acquisition-related expenses (3)	120	139	120	963
Stock-based compensation (4)	812	618	1,481	1,320
Non-GAAP net income	\$ 1,370	\$ 3,751	\$ 2,088	\$ 4,565
GAAP basic net income (loss) per share	(\$ 0.00)	\$ 0.03	(\$ 0.02)	(\$ 0.01)
Non-GAAP adjustments to basic income (loss) per share:				
Amortization and other non-cash acquisition related charges (1)	\$ 0.01	\$ 0.02	\$ 0.03	\$ 0.05
Severance expenses (2)	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
Acquisition-related expenses (3)	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.02

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Stock-based compensation (4)	\$	0.01	\$	0.01	\$	0.02	\$	0.02
Non-GAAP basic net income per share	\$	0.02	\$	0.06	\$	0.03	\$	0.08
Non-GAAP diluted net income per share	\$	0.02	\$	0.06	\$	0.03	\$	0.08
GAAP weighted average shares outstanding used in calculating basic net income (loss) per share		60,634,849		59,437,038		60,269,804		58,229,078
GAAP weighted average shares outstanding used in calculating diluted net income (loss) per share		60,634,849		61,530,085		60,269,804		58,229,078
Adjustments for dilutive potential common stock		4,795,261		888,109		4,497,589		2,049,456
Weighted average shares outstanding used in calculating non-GAAP diluted net income per share		65,430,110		62,418,194		64,767,393		60,278,534

- (1) *Amortization and other non-cash acquisition-related charges* are non-cash charges, such as amortization of acquired intangibles, that can be impacted by the timing and magnitude of our acquisitions. We consider our operating results without these charges when evaluating our ongoing performance and/or predicting our earnings trends, and therefore exclude such charges when presenting non-GAAP financial measures. We believe the assessment of our operations excluding these costs is relevant to our assessment of internal operations and comparisons to the performance of other companies in our industry.

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- (2) *Severance expenses* include acquisition related severance expenses and are disregarded by our management when evaluating and predicting earnings trends because these charges are unique to specific acquisitions, and are therefore excluded by us when presenting non-GAAP financial measures.
- (3) *Acquisition-related costs* include direct costs of the acquisition and expenses related to acquisition integration activities. Examples of costs directly related to an acquisition include transaction fees, due diligence costs and certain legal costs related to acquired litigation which are included in general and administrative expenses in our statement of operations. These expenses vary significantly in size and amount and are disregarded by our management when evaluating and predicting earnings trends because these charges are unique to specific acquisitions, and are therefore excluded by us when presenting non-GAAP financial measures.
- (4) *Stock-based compensation expense* consist of expense relating to stock-based awards issued to employees, outside directors and non employees including stock options, restricted stock units, restricted stock units with performance-based vesting and our Employee Stock Purchase Plan. Because of varying available valuation methodologies, subjective assumptions and the variety of award types, we believe that the exclusion of stock-based compensation expense allows for more accurate comparisons of our operating results to our peer companies, and for a more accurate comparison of our financial results to previous periods. In addition, we believe it is useful to investors to understand the specific impact of stock-based compensation expenses on our operating results.
- (5) *Depreciation expense* includes depreciation and amortization of leasehold improvements, furniture and fixtures, machinery and equipment, software and computers and equipment. Our management excludes this charge from operating income (loss) to compute non-GAAP earnings before income taxes, depreciation and amortization.

## **Liquidity and Capital Resources**

On June 30, 2011, we had working capital of \$38.0 million, which included \$37.1 million of cash and cash equivalents.

In March 2009, we entered into a Loan and Security Agreement (the "Loan Agreement") with Silicon Valley Bank ("Lender") for a \$6.0 million secured revolving loan facility and a \$3.0 million secured term loan. We drew down \$3.8 million on the revolving loan facility and \$3.0 million as a term loan in March 2009, and repaid the revolving loan in full in April 2009. On June 30, 2009, we entered into an amendment to the Loan Agreement which provides for an increase of the secured revolving loan facility to \$8.0 million and an additional \$1.0 million secured term loan. On March 31, 2010, we entered into a third amendment to the Loan Agreement which provides for an increase of the commitment under the loan facility by adding a \$10.0 million secured term loan facility, amended certain financial covenants and extended the term of the existing revolving loan facility. On October 15, 2010, we entered into a fourth amendment to the Loan Agreement, which authorized us to consummate the acquisition of CLRS Technology Corporation on October 15, 2010. On April 20, 2011, the Company entered into a fifth amendment to the Loan Agreement, which extended the borrowing period for term loans borrowed under the secured term loan facility from March 31, 2011 to March 31, 2012, and extended the maturity date of such borrowings for term loans borrowed under the secured term loan facility from December 31, 2013 to December 31, 2014. Other terms of the Loan Agreement remain unchanged. The Loan Agreement contains financial covenants requiring us to maintain a minimum liquidity ratio and minimum EBITDA. We were in compliance with these covenants as of June 30, 2011. At June 30, 2011, \$8 million was outstanding on the revolving loan facility and \$0.9 million was outstanding on the secured term loan. We repaid all funds drawn from the revolving loan facility in July 2011.

Our future capital requirements depend on a number of factors, including the rate of market acceptance of our current and future products, the resources we devote to developing and supporting our products, and continued progress of our research and development of new products.

We expect to increase capital expenditures consistent with our anticipated growth in manufacturing, infrastructure and personnel. We also may increase our capital expenditures as we expand our product lines or invest to address new markets.

We believe that our current cash and cash equivalent balances and cash generated from operations, along with our existing credit facilities, will meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months. Our future liquidity requirements may increase beyond currently expected levels if we fail to maintain compliance with covenants in our bank loan agreements or if unanticipated expenses or other uses of our cash arise. We have consummated acquisitions of other businesses in the past and continue to evaluate potential strategic acquisitions of complementary businesses, products or technologies. If we elect to complete additional acquisitions in the future our cash needs are likely to exceed beyond the amount of cash we currently expect to have to fund our operations. In order to meet our future liquidity needs or to fund acquisitions, we may seek



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additional equity and/or debt financing. Such additional financing may not be available on a timely basis on terms acceptable to us, or at all, particularly in the short-term due to the current credit and equity market funding environments. Any future equity financing would result in dilution to our stockholders. The availability of financing or merger opportunities will depend, in part, on market conditions, and the outlook for our company.

*Net Cash Provided by Operating Activities.* Net cash provided in operating activities was \$0.2 million for the first half of 2011 compared to net cash of \$7.8 million provided by operating activities for the same period in 2010. During the first half of 2011, cash was used for a \$3.1 million increase in inventory, a \$0.7 million increase in accounts receivable, a \$0.3 million increase in prepaid expenses and other current assets and a \$1.4 million decrease in accrued liabilities. These were partially offset by \$4.0 million in net cash provided from net loss after adjusting for non-cash items, an increase in accounts payable of \$1.0 million, an increase in deferred revenue of \$0.7 million and customer deposits of \$0.2 million. During the first half of 2010, cash was provided by a decrease of \$2.0 million in accounts receivable, a \$1.3 million decrease in inventory, a \$0.9 million decrease in prepaid expenses and other current assets and \$5.2 million net cash provided from net loss after adjusting for non-cash items. These were partially offset by \$1.0 million decrease in deferred revenue and a \$0.9 million decrease in accrued and other liabilities.

*Net Cash Used in Investing Activities.* Net cash used in investing activities was \$0.6 million for the first half of 2011 compared with \$1.1 million cash used in investing activities during the same period in 2010. During the first half of 2011, net cash of \$0.6 million was used for payments to acquire property and equipment. During the first half of 2010, net cash of \$0.9 million was used for payments to acquire property and equipment and \$0.2 million was used for the acquisition of Aesthera, net of cash received.

*Net Cash Provided by Financing Activities.* Net cash provided by financing activities was \$0.6 million for the first half of 2011 compared with \$15.6 million of net cash provided by financing activities in the same period in 2010. During half of 2011, we received \$1.4 million in proceeds from exercise of stock options and the employee stock purchase plan, partially offset by net payments of \$0.8 million on our term loans. During the first half of 2010, we completed a private placement offering which resulted in net proceeds of \$15.8 million in cash and we also received \$0.7 million in proceeds from exercise of stock options and the employee stock purchase plan, partially offset by net payments of \$0.7 million on our term and revolving loans and \$0.1 million to settle tax obligations on behalf of our employees for the issuance of restricted stock units.

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not have any undisclosed borrowings or debt, and we have not entered into any synthetic leases. We are, therefore, not materially exposed to any financing, liquidity, market or credit risk that could arise if we engaged in such relationships.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

### ***Foreign Currency Risk***

Currently, most of our sales and purchases are denominated in U.S. dollars, although, 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.

### ***Interest Rate Risk***

Changes in interest rates will impact our interest sensitive credit agreement and accordingly may impact interest expense. We have determined that if interest rates were to instantaneously increase (decrease) by 100 basis points, there would be no material impact to interest expense over a year period.

## **ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures.** Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act of 1934, as amended) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and

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communicated to management including our Chief Executive Officer and our Chief Financial Officer as appropriate to allow for timely decisions regarding required disclosure.

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**Changes in Internal Control Over Financial Reporting.** There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

The Company is involved in litigation as discussed in Note 7 of the Notes to the Financial Statements disclosed in this Company's Quarterly Report on Form 10-Q.

In addition, from time to time, we are subject to legal proceedings and claims with respect to such matters as patents, intellectual property rights, product liability claims and contractual disputes with distributors, suppliers and others, arising out of the normal course of business. Litigating claims of these types, whether or not ultimately determined in our favor or settled by us, is costly and diverts the efforts of management and other personnel from normal business operations. The results of legal proceedings cannot be predicted with certainty. The Company does not believe the final disposition of these matters will have a material adverse effect on the financial statements and future cash flows of the Company.

### **ITEM 1A. RISK FACTORS**

#### **Item 1A. Risk Factors**

##### **Risks Related to Our Business**

**We are in a difficult economic period, and the uncertainty in the economy has reduced and may continue to reduce patient demand for our products; if there is not sufficient patient demand for our product's procedures, practitioner demand for these systems could drop, resulting in unfavorable operating results.**

Recent distress in the financial markets has had an adverse impact on our business. The aesthetic industry in which we operate is particularly vulnerable to economic trends. The decision to undergo a procedure from one of our systems is driven by consumer demand. Most procedures performed using our systems are elective procedures, the cost of which must be borne by the patient, and are not reimbursable through government or private health insurance. In times of economic uncertainty or recession, individuals often reduce the amount of money that they spend on discretionary items, including aesthetic procedures. The general economic difficulties being experienced by our customers and the lack of availability of consumer credit for some of our customers are adversely affecting the market in which we operate.

If the current situation continues or deteriorates further, our business would be negatively impacted and our financial performance would be materially harmed in the event that any of the above factors discourage patients from seeking our product's procedures.

**We are totally dependent upon the success of our systems, which have a limited commercial history. If our products fail to achieve sufficient market acceptance, our business will suffer.**

We expect that sales of our systems, including our treatment tips, will account for substantially all of our revenue for the foreseeable future. We expect to continue to expand our line of systems and treatment tips. This may not occur when expected, or at all, which would negatively affect our anticipated revenue. Our systems may not significantly penetrate current or new markets. If demand for our systems does not increase as we anticipate, or declines, our business, financial condition and results of operations will be harmed.

**Our financial results may fluctuate unpredictably, making it difficult to forecast future performance.**

Our limited operating history makes it difficult for us to predict future performance. Historically, the demand for our systems has varied from quarter to quarter. A number of factors, over which we have limited or no control, may contribute to fluctuations in our financial results, such as:

delays in receipt of anticipated purchase orders;

seasonal variations in patient demand for aesthetic procedures;

the impact of general economic conditions on the demand for aesthetic procedures;



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performance of our independent distributors;

the lack of credit available to physicians to finance capital equipment purchases;

positive or negative media coverage of our products or products of our competitors or our industry;

our ability to obtain further regulatory clearances or approvals;

delays in, or failure of, product and component deliveries by our subcontractors and suppliers;

changes in the length of the sales process;

the costs of litigation claims or adverse outcomes from legal proceedings;

customer response to the introduction of new product offerings;

fluctuations in foreign currency; and

excess or obsolete inventory charges.

### **Our success depends on growing physician adoption of our systems and continued use of our treatment tips.**

Our target physician customers typically already own one or more aesthetic device products. Our ability to grow our business and convince physicians to purchase our systems and products depends on the success of our clinical and sales and marketing efforts. Our business model involves both a capital equipment purchase of our systems and continued purchases by our customers of our treatment tips. This may be a novel business model for many potential customers who may be used to competing products that are either exclusively capital equipment, such as many laser-based systems, or that are exclusively single-use products, such as Botox or dermal fillers. In addition, the lack of credit available to physicians to finance the purchase of systems may also impact the adoption of these systems. We must be able to demonstrate that the cost of our systems and the revenue that the physician can derive from performing procedures using our product are compelling when compared to the cost and revenue associated with alternative products. When marketing to plastic surgeons, we must also, in some cases, overcome a bias against non-invasive or minimally invasive aesthetic procedures. If we are unable to increase physician adoption of our systems and use of our treatment tips, our financial performance will be adversely affected.

### **We may not be able to achieve or sustain profitability even if we are able to generate significant revenue.**

We incurred a loss of \$2.0 million for the year ended December 31, 2010 and a loss of \$1.2 million for the six months ended June 30, 2011. In the past, we have expanded our business and increased our expenses in order to grow revenue. We will have to increase our revenue while effectively managing our expenses in order to achieve sustained profitability. Our failure to achieve or sustain profitability could negatively impact the market price of our common stock.

### **We are subject to fluctuations in the exchange rate of the U.S. dollar and foreign currencies.**

As a result of recent fluctuations in currency markets, our products priced in U.S. dollars may be more expensive relative to products of our foreign competitors, which could result in lower revenue and profit margins. We do not actively hedge our exposure to currency rate fluctuations. While we transact business primarily in U.S. dollars, and a significant proportion of our revenue is denominated in U.S. dollars, a

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growing proportion of our revenue and costs is denominated in other currencies, such as the Australian Dollar, Euro, Japanese Yen, and British Pound Sterling. In addition, the functional currency of the Company's foreign subsidiaries is the U.S. dollar. As a result, our financial performance could be adversely affected by changes in the exchange rates of these currencies to the U.S. Dollar.

### **We may not be successful in selling and marketing our new products.**

The commercial success of the products and technologies we develop will depend upon the acceptance of these products by physicians and their patients. It is difficult for us to predict how successful recently introduced products and procedures or products we are currently developing, will be over the long term. If the products we develop do not gain market acceptance, our revenues and operating results will suffer. In addition, we expect to face significant competition, in some cases from companies that are more established, market more widely known products and have greater resources than we do. We may not be able to differentiate our new products sufficiently from our competitors' products to achieve significant market penetration. As a result of these factors, we may incur significant sales and marketing expenses for our new products without achieving commercial success, which could harm our business and our competitive position.

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In addition, as new or enhanced products are introduced, we must successfully manage the transition from older products in order to minimize disruption in customers' ordering patterns, avoid excessive levels of older product inventories, and ensure that enough supplies of new products can be delivered to meet customer demand.

### **The failure of our systems to meet patient expectations or the occurrence of unpleasant side effects from our product's procedures could impair our financial performance.**

Our future success depends upon patients having a positive experience with our product's procedures in order to increase physician demand for our products, as a result of both individual patients' repeat business and as a result of word-of-mouth referrals. We believe that patients may be dissatisfied with our product's procedures if they find them to be too painful. Furthermore, patients may experience temporary swelling or reddening of the skin as a procedural side effect. In rare instances, patients may receive burns, blisters, skin discoloration or skin depressions. Experiencing excessive pain or any of these side effects or adverse events could discourage a patient from having one of our product's procedures or discourage a patient from having additional procedures or referring our product's procedures to others. In order to generate repeat and referral business, we also believe that patients must be satisfied with the effectiveness of the procedures. Results obtained from our product's procedure are subjective and may be subtle. A product treatment may produce results that may not meet patients' expectations. If patients are not satisfied with the procedure or feel that it is too expensive for the results obtained, our reputation and future sales will suffer.

### **The conditions of our secured term loan contain certain financial covenants with respect to our performance and other covenants that restrict our activities. If we are unable to comply with these covenants, we would have to negotiate an amendment to the loan agreement or the lender could accelerate the repayment of our indebtedness.**

Our secured term loan contains certain financial covenants which require us to maintain a certain liquidity ratios and specified levels of EBITDA (as defined in the loan agreement) each fiscal quarter. We are also subject to restrictive covenants, including among others covenants that restrict our ability to incur additional indebtedness, to dispose of assets, to effect certain corporate transactions, including specified mergers or acquisitions, and to pay dividends. The loan agreement generally provides for customary events of default, including among others non-payment defaults, covenant defaults, and a default in the event a material adverse change occurs. There is no assurance that we will be able to comply with our financial covenants. Upon the occurrence of an event of default under the term loan, the lender will be entitled to acceleration of all obligations under the loan agreement and an obligation to repay all obligations in full and such event of default could result in an increase to the applicable interest rate of 5.00%. Any acceleration in the repayment of our indebtedness could adversely affect our business and financial condition.

### **We may face problems with our acquisition of CLRS Technology Corporation.**

On October 15, 2010 we completed our acquisition of CLRS Technology Corporation, or CLRS, a developer, manufacturer and marketer of a personal care light-based aesthetic system.

We cannot be certain that this acquisition will be successful or that we will realize the anticipated benefits of the acquisition. In particular, we may not be able to realize the strategic and operational benefits and objectives we had anticipated, including, greater revenue and market opportunities, maintaining industry leadership and consistent profitability. In addition, the demand for our combined product offerings may fluctuate and we may face increased competition in the markets for our products. Any of these factors and the following factors, as well as the inability to realize the long-term anticipated efficiencies and synergies of the acquisition of CLRS, may have a material adverse effect on our business, operating results and financial condition. These factors may include:

the potential disruption of the combined company's ongoing business and diversion of management resources;

the difficulty of incorporating acquired products, technology and rights into the combined company's products and services;

unanticipated expenses related to integration of operations;

the possibility that we are unsuccessful in marketing directly to consumers, which is the market targeted by CLRS;

the impairment of relationships with customers as a result of any integration of new personnel;

potential unknown liabilities associated with the acquired business and technology;

potential periodic impairment of goodwill and intangible assets acquired; and

potential inability to retain, integrate and motivate key personnel.

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

Our growth strategy includes evaluation of potential strategic acquisitions of complementary businesses, products or technologies. We may also consider joint ventures and other collaborative projects. We have incurred integration costs related to the acquisitions of Reliant and Aesthera Corporation. We may incur similar expenses in future periods as we complete our integration plan in connection with our acquisition of CLRS Technology Corporation, as well as expenses associated with evaluation of other potential strategic transactions. Such expenditures could negatively impact our financial performance in future periods.

We may not be able to successfully integrate the combined business, products or technologies. In addition, the integration of such acquisition and management of any collaborative project may divert management's time and resources from our core business and disrupt our operations. If we decide to expand our product offerings, we may spend time and money on projects that do not increase our revenue. Any cash acquisition we pursue would diminish funds available to us for other uses, and any stock acquisition would dilute our stockholders' ownership.

### **We may fail to effectively build and manage our sales force or to market and distribute our products.**

We rely on a direct sales force to sell our products in the United States and in certain international regions. As the Company grows, we expect to grow or realign our sales organization to meet our anticipated sales objectives. There are significant risks involved in building and managing our sales organization, including risks related to our ability to:

hire qualified individuals as needed;

provide adequate training for the effective sale of our products; and

retain and motivate our sales employees.

In addition, sales to non-traditional practitioners of aesthetic procedures are a key element of our growth strategy. However, our sales force historically has sold primarily to dermatologists and plastic surgeons. Also, our systems compete with products that are well-established in the market. Accordingly, it is difficult for us to predict how well our sales force will perform. Our failure to adequately address these risks could have a material adverse effect on our ability to sell our products, causing our revenue to be lower than expected and harming our results of operations.

### **We may be required to raise additional capital and/or debt financing on unfavorable terms.**

Our future liquidity requirements may increase beyond currently expected levels if we fail to achieve sustained profitability or if unanticipated expenses or other uses of cash arise. In order to meet our liquidity needs, we may be required to seek additional equity and/or debt financing. Additional financing may not be available on a timely basis on terms acceptable to us, or at all, particularly in the short-term due to the current credit and equity market funding environments. The availability of financing will depend, in part, on market conditions, and the outlook for our company. Any future equity financing would result in substantial dilution to our stockholders. If we raise additional funds by issuing debt, we may be subject to limitations on our operations, through debt covenants or other restrictions. If adequate funds are not available, we may have to delay development of new products or reduce marketing, customer support or other resources devoted to our products. In addition, if we are unable to obtain financing as needed, we may come into breach of our outstanding loan covenants. Any of these factors could harm our business and financial condition.

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

Litigation related to infringement and other intellectual property claims, with or without merit, is unpredictable, can be expensive and time-consuming and could divert management's attention from our core business. 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. 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.

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Our industry has been characterized by frequent intellectual property litigation. Our competitors or other patent holders may assert that our products and the methods we employ are covered by their patents. If our products or methods are found to infringe, we could be prevented from marketing them. In addition, we do not know whether our competitors or potential competitors have applied for, or will apply for or obtain, patents that will prevent, limit or interfere with our ability to make, use, sell, import or export our products. Competing products may also appear in other countries in which our patent coverage might not exist or be as strong. If we lose a foreign patent lawsuit, we could be prevented from marketing our products in one or more countries.

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In addition, we may hereafter become involved in litigation to protect our trademark rights associated with our company name or the names used with our products. Names used with our products and procedures may be claimed to infringe names held by others or to be ineligible for proprietary protection. If we have to change the name of our company or products, we may experience a loss in goodwill associated with our brand name, customer confusion and a loss of sales.

### **We are involved in litigation relating to our acquisition of Reliant Technologies, Inc., which could be costly and time consuming.**

On December 21, 2009, a complaint was filed in the Santa Clara County Superior Court by three former stockholders of Reliant Technologies, Inc. against Reliant and certain former officers and directors of Reliant in connection with our acquisition of Reliant, which closed on December 23, 2008. The complaint purports to be brought on behalf of the former common stockholders of Reliant. As a result of the acquisition, a successor entity to Reliant, Reliant Technologies, LLC, became our wholly-owned subsidiary. Eric Stang and Leonard DeBenedictis are among the defendants named in the complaint. Mr. Stang is a member of our board of directors, and Mr. DeBenedictis is a former member of our board of directors and our former Chief Technology Officer. The principal claim, among others, is that Reliant violated the California Corporations Code by failing to obtain the vote from a majority of holders of Reliant's common stock prior to the consummation of the acquisition. The complaint also purports to challenge disclosures made by Reliant in connection with its entry into the acquisition and that the defendants failed to maximize the value of Reliant for the benefits of Reliant's common stockholders. On August 2, 2010, defendants filed a motion to dismiss or stay the entire action based on a mandatory forum selection clause in the merger agreement which requires that claims related to the merger be litigated in Delaware. On September 28, 2010, the Court granted the defendants' motion to dismiss or stay, and stayed the action indefinitely. To date, the plaintiffs have not filed a complaint against the defendants in Delaware. We believe that this suit is without merit, and we intend to vigorously defend it. Although we do not expect that the final disposition of this litigation will have a material adverse effect on our financial results, we may have to devote certain personnel and resources to resolve this litigation.

### **Intellectual property rights may not provide adequate protection for our products, which may permit third parties to compete against us more effectively.**

We rely on a combination of patent, copyright, trademark and trade secret laws and confidentiality and invention assignment agreements to protect our intellectual property rights. As of June 30, 2011, we had 94 issued U.S. patents, 70 pending U.S. patent applications, 55 issued foreign patents and 54 pending foreign patent applications, some of which foreign applications preserve an opportunity to pursue patent rights in multiple countries. Some of our system components 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, we do not have patent rights in all foreign countries in which a market may exist, and where we have applied for foreign patent rights, the laws of many foreign countries will not protect our intellectual property rights to the same extent as the laws of the United States.

In addition, competitors could purchase our systems and attempt to replicate some or all of the competitive advantages we derive from our development efforts, willfully infringe our intellectual property rights, 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 so as to protect our market against competitors' products and methods, our competitive position could be adversely affected, as could our business.

### **Performing clinical studies on, and collecting data from our product's procedures is inherently subjective, and we have limited data regarding the efficacy of our systems. If future data is not positive or consistent with our prior experience, rates of physician adoption will likely be harmed.**

We believe that in order to significantly grow our business, we will need to conduct future clinical studies of the effectiveness of our systems. Clinical studies of aesthetic treatments are subject to a number of limitations. First, these studies do not involve well-established objective standards for measuring the effectiveness of treatment. Subjective, before and after, evaluation of the extent of change in the patient's appearance, performed by a medical professional or by the patient, is the most common method of evaluating effectiveness. A clinical study may conclude that a treatment is effective even if the change in appearance is subtle and not long-lasting. Second, as with other non-invasive or minimally invasive energy-based devices, the effect of our product's procedures vary from patient to patient and can be influenced by a number of factors, including the area of the body being treated, the age and skin laxity of the patient and operator technique.





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We have not conducted any head-to-head clinical studies that compare results from treatment with our systems to surgery or treatment with other aesthetic devices. Without head-to-head studies against competing alternative treatments, which we have no current plans to conduct, potential customers may not find clinical studies of our technology sufficiently compelling to purchase our systems. If we decide to pursue additional studies in the future, they could be expensive and time consuming, and the data collected may not produce favorable or compelling results. If the results of such studies do not meet physicians' expectations, our systems may not become widely adopted, physicians may recommend alternative treatments for their patients, and our business may be harmed.

### **To successfully market and sell our systems internationally, we must address many issues with which we have limited experience.**

Sales outside of North America accounted for 55%, 53% and 48% of our revenue for the years ended December 31, 2010, 2009 and 2008. We believe that a significant portion of our business will continue to come from international sales through increased penetration in countries where we currently sell our products, combined with expansion into new international markets. However, international sales are subject to a number of risks, including:

difficulties in staffing and managing our international operations;

difficulties in penetrating markets in which our competitors' products are more established;

reduced or no protection for intellectual property rights in some countries;

export restrictions, trade regulations and foreign tax laws;

regulation of the sale of the hydrofluorocarbon used with our ThermoCool system;

fluctuating foreign currency exchange rates;

foreign certification and regulatory clearance or approval requirements;

difficulties in developing effective marketing campaigns for unfamiliar, foreign countries;

dependence on third-party distributors in some territories;

customs clearance and shipping delays;

political and economic instability;

natural disasters (such as earthquakes, hurricanes, tsunamis, floods or storms);

preference for locally produced products;

business interruption resulting from transitioning to direct sales from international distributors in certain international regions; and

difficulties in getting distributors to relinquish regulatory documentation.

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 unable to find a solution, our revenue may decline.

The recent earthquake, tsunami and subsequent problems affecting nuclear power plants in Japan could have a negative impact on our international sales, our supply chain, our ability to deliver products, the cost of our products, and the demand for our products. As a result of these events, we may, in the future, encounter reduced demand from our Japanese customers and distributors. In addition, even if supply is not interrupted or delayed, or demand from Japanese customers and distributors is not reduced, shortages of key items in Japan may result in price increases, which our suppliers in Japan may seek to pass on to us. In addition, our suppliers outside of Japan may be unable to produce finished components as a result of Japanese related supply chain disruptions. Any such occurrences could have a material adverse effect on our business, our results of operations and our financial condition.

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### **To market and sell our products internationally, we depend on distributors, and they may not be successful.**

We currently depend primarily on third-party distributors to sell and service our products internationally and to train our international customers, and if these distributors terminate their relationships with us or under-perform we may be unable to maintain or increase our level of international revenue. We will also need to engage additional international distributors to grow our business and expand the territories in which we sell our systems. Distributors may not commit the necessary resources to market, sell and service our products to the level of our expectations. If current or future distributors do not perform adequately, or if we are unable to engage distributors in particular geographic areas, our revenue from international operations will be adversely affected. In addition, from time to time, legal disputes arise when we wish to discontinue a distributor relationship in a given territory or otherwise feel a distributor is not performing adequately. Such disputes have led to legal proceedings that are costly to litigate and that could result in outcomes that are not favorable to us.

### **New legislation regarding healthcare reform may affect our revenue and financial condition.**

The U.S. government has recently enacted healthcare reform and is currently considering and may in the future consider healthcare policies and proposals intended to curb rising costs, including those that could significantly affect both private and public reimbursement for healthcare services. State and local governments, as well as a number of foreign governments, are also considering or have adopted similar types of policies. Such policies and proposals include changes that would change the dynamics of the health care industry, including having the federal or one or more state governments assume a larger role in the health care system such as competing with private health insurers, imposing new taxes on health insurers, or restructuring of the Medicare or Medicaid programs. We are unable to predict the ongoing uncertainty about these matters and the effect they will have on the purchasing decisions of our customers.

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

The aesthetics market is highly competitive and dynamic, and is marked by rapid and substantial technological development and product innovations. Demand for our products could be diminished by equivalent or superior products and technologies offered by competitors. Specifically, our products compete against a variety of offerings in the aesthetics market, including laser and other light-based medical devices, pharmaceutical products such as Botox, filler injections, chemical peels, microdermabrasion, liposuction, cosmetic surgical procedures and less invasive surgical solutions such as implanted sutures. Our closest competitors are makers of laser and other light-based devices, which include companies such as Alma Lasers, Cutera, Cynosure, Lumenis, Lutronic, Palomar Medical Technologies, Sciton and Syneron Medical.

Competition in the aesthetics market 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. Our ability to compete effectively depends upon our ability to distinguish our company and our products from our competitors and their products, and on such factors as:

safety and effectiveness;

product pricing;

success of our marketing initiatives;

compelling clinical data;

intellectual property protection;

quality of customer support; and

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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 thus may decide not to purchase our products, or to delay such purchase. 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, 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 line. Given the relatively few competitors currently in the market, any business combination could exacerbate any existing competitive pressures, which could harm our business.

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### **Competition among providers of devices for the aesthetics 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 rights, there are few barriers to entry that would prevent new entrants or existing competitors from developing products that compete directly with ours. If we continue to create market demand for non-surgical, non-invasive or minimally invasive treatments, competitors will enter the market with other products making similar or superior claims. We expect that any competitive advantage we may enjoy from our current and future innovations 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 systems could become obsolete and our revenue will decline as our customers purchase competing products.

Our products may have undetected and unforeseen design flaws, and may experience failures particularly when first introduced, or at any time during their lifecycle. Any product recall as a result of flaws or failures could result in the loss of or delays in market acceptance of our products and adversely affect our business and reputation. Correcting defects can be time consuming. Any significant returns or warranty claims could result in significant additional costs to us and could adversely affect our results of operations.

### **Negative publicity regarding our current or future products and procedures could harm demand, which would adversely affect sales and our financial performance.**

We have in the past experienced, and expect that in the future we will experience, negative media exposure. Such publicity may present negative individual physician or patient experience regarding the safety or effectiveness of our procedures. Competitors could attempt to use such publicity to harm our reputation and disrupt current or potential future customer relationships. While, to date, we have not observed a material impact on our quarterly financial results of operations from negative publicity, future results could be negatively impacted. Additionally, while we believe that obtaining positive publicity is important to our success, and it is an important component of our marketing efforts, we have also not observed a material impact on our quarterly financial results of operations from positive publicity.

Our reputation and competitive position may be harmed not only by negative media exposure, but also by other publicly-available information suggesting that our procedures are not safe. For example, we file reports with the FDA that are publicly available on the FDA's website if our product may have caused or contributed to a serious injury or malfunctioned in a way that would likely cause or contribute to a serious injury if it were to recur. Competitors may attempt to harm our reputation by pointing to isolated injuries that have been reported or publicized, or by claiming that their product is superior because they have not filed as many reports with the FDA. Such negative publicity and competitor behavior could harm our reputation and our future sales.

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

Several components and materials that comprise our products are currently manufactured by a single supplier or a limited number of suppliers. In many of these cases, we have not yet qualified alternate suppliers and rely upon purchase orders, rather than long-term supply agreements. A supply interruption or an increase in demand beyond our current suppliers' capabilities could harm our ability to manufacture our products until new sources of supply are 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 to obtain adequate supply on commercially reasonable terms;

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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;

damage to our brand reputation caused by defective components produced by our suppliers;

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interruption or delay of supply due to a natural disaster affecting supplier's operations;

increased cost of our warranty program due to product repair or replacement based upon defects in components produced by our suppliers; 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.

**If, in the future, we decide to perform additional manufacturing functions internally that we currently outsource, our business could be harmed by our limited manufacturing experience and related capabilities.**

We currently perform certain value-added and proprietary manufacturing processes internally at our principal facility, and we outsource the manufacture of components, subassemblies and certain finished products to a limited number of third parties. For financial or operational purposes, we may elect to perform additional component or system manufacturing functions internally. In that event, we may face a number of challenges beyond those that we currently address in our internal assembly, inspection, testing and certification activities. Implementing complex or specialized manufacturing processes could lead to difficulties in producing sufficient quantities of manufactured items that meet our quality standards and that comply with applicable regulatory requirements in a timely and cost-effective manner. In addition, if we experience these types of internal manufacturing difficulties, it may be expensive and time consuming to engage a new or previous subcontractor or supplier to fulfill our replacement manufacturing needs. The occurrence of any of these events could harm our business.

Problems in our manufacturing processes, or those of our manufacturing subcontractors, that lead to an actual or possible malfunction in our products, may require us to recall products from customers and could disrupt our operations. Our results of operations, our reputation and market acceptance of our products could be harmed if we encounter difficulties in manufacturing that result in a recall or patient injury, and delays in our ability to fill customer orders.

**We outsource the repair of key elements of some products to sole-source service subcontractors.**

We outsource the repair of certain key elements of our systems to sole source contract service providers. If the operations of those service subcontractors are interrupted, we may be limited in our ability to repair equipment. Our service subcontractors are dependent on trained technical labor to effectively repair our products. In addition, our service subcontractors may be operating as medical device manufacturers and as such are required to demonstrate and maintain compliance with the FDA's Quality System Regulation, or QSR. If our service subcontractors fail to comply with the FDA's QSR, repair operations could be affected and our ability to repair certain systems may be impaired.

**We may not be able to develop an alternative cooling system that will be in compliance with changing environmental regulations in a timely or cost-effective manner.**

The cooling capability of our Thermage and Isolaz systems relies upon a hydrofluorocarbon, or HFC, called R134a, to protect the outer layer of the skin from over-heating while our device delivers RF energy to the subcutaneous tissue. New environmental regulations phasing out certain HFCs over the next decade have been adopted or are under consideration in a number of countries, and recent European Union directives require the phase-out of certain HFCs. We have also put in place a solution for the European Union import restrictions. If we are unable to develop an alternative cooling system for our device which is not dependent on R134a in a timely or cost-effective manner, our Thermage and Isolaz systems may not be in compliance with environmental regulations, which could result in fines, civil penalties and the inability to sell our products in certain major international markets.

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

We keep limited materials, components and finished product 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 six 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 inventory, which would increase our expenses. If we underestimate

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our component and material requirements, we may have inadequate inventory, which could interrupt, delay or prevent delivery of systems 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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**Even though we require training for users of our professional systems, there exists a potential for misuse, which could harm our reputation and our business.**

Federal (US) regulations allow us to sell our professional systems to licensed practitioners. The definition of licensed practitioners varies from state to state. As a result, our professional systems may be operated by licensed practitioners with varying levels of training, and in many states by non-physicians, including physician assistants, registered nurses and nurse practitioners. Thus, in some states, the definition of licensed practitioner may result in the legal use of our professional products by non-physicians. Outside the United States, our independent distributors sell in many jurisdictions that do not require specific qualifications or training for purchasers or operators of products. We do not supervise the procedures performed with our professional systems, nor can we be assured that direct physician supervision of our equipment occurs according to our recommendations. We, and our distributors, require purchasers of our professional products to undergo an initial training session as a condition of purchase, but do not require ongoing training. In addition, we prohibit the sale of our professional systems to companies that rent our systems to third parties without our approval, but cannot prevent an otherwise qualified physician from contracting with a rental company in violation of their purchase agreement with us. The use of our professional systems by non-physicians, as well as noncompliance with the operating guidelines set forth in our training programs, 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 defective design, labeling, 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. For example, as described under Legal Proceedings, one such litigation matter is currently pending. Misusing our products or failing to adhere to operating guidelines could cause significant skin damage and underlying tissue damage. In addition, if our operating guidelines or product design are found to be inadequate, we may be subject to liability. We have been, continue to be 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 claim 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. Product liability claims in excess of our insurance coverage would be paid out of cash reserves, harming our financial condition and reducing our operating results.

**After-market modifications to our treatment tips by third parties and the development of counterfeit treatment tips could reduce our sales, expose us to product liability litigation and dilute our brand quality.**

Third parties have introduced adulterated after-market modifications to our treatment tips which have enabled re-use of our treatment tips in multiple procedures. Because our treatment tips are designed to withstand a finite number of firings, modifications intended to increase the number of firings could result in patient injuries caused by the use of worn-out or damaged treatment tips. In addition, third parties may seek to develop counterfeit treatment tips that are compatible with our systems and available to practitioners at lower prices than our own. If security features incorporated into the design of our systems are unable to prevent after-market modifications to our treatment tips or the introduction of counterfeit treatment tips, we could be subject to reduced treatment tip sales, product liability lawsuits resulting from the use of damaged or defective goods and damage to our reputation for providing a quality product.

**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. Many of our officers and key employees do not have employment contracts with us and can terminate their employment at any time. 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, as well as independent distributors, most of whom are geographically dispersed and must be trained in the use and benefits of our products. 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.



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**Risks Related to Regulatory Matters**

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

Our systems 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 claim for an existing product, can be marketed in the United States, it must first receive either 510(k) clearance or premarket approval from the FDA, unless an exemption applies. Either process can be expensive and lengthy. The FDA's 510(k) clearance process usually takes from three to 12 months, but it can take significantly longer. The process of obtaining premarket approval is much more costly and uncertain than the 510(k) clearance process, and it generally takes from one to three years, or even longer, from the time the application is filed with the FDA.

Medical devices may be marketed only for the indications for which they are approved or cleared. We have obtained 510(k) clearance for various indications for our Thermage and Fraxel systems. In addition, 510(k) clearance has been obtained for various indications of our recently acquired Isolaz systems and CLARO products. However, our clearances can be revoked if safety or effectiveness problems develop. We are also subject to Medical Device Reporting regulations, which require us to report to the FDA if our product causes or contributes to a death or serious injury, or malfunctions in a way that would likely cause or contribute to a death or serious injury if the malfunction were to recur. 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 systems 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 and operate our systems. However, a state could change its regulations at any time, 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;

repair, replacement, refunds, recall or seizure of our product;

operating restrictions or partial suspension or total shutdown of production;

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

withdrawing 510(k) clearance or premarket approvals that have already been granted; and

criminal prosecution.

If any of these events were to occur, our business could be harmed.

**If we modify our FDA-cleared devices, we may need to seek and obtain new clearances, which, if not granted, would prevent us from selling our modified product or require us to redesign our product.**

Any modification to an FDA-cleared device that would significantly affect its safety or effectiveness or that would constitute a change in its intended use would require a new 510(k) clearance or possibly a premarket approval. We may not be able to obtain additional 510(k) clearances or premarket 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 clearances would adversely affect our ability to introduce new or enhanced products in a timely manner, which in turn

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would harm our revenue and potential 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 clearances 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 product.

### **If we or our suppliers and subcontractors fail to comply with the FDA's Quality System Regulation, our business would suffer.**

We and our suppliers and subcontractors are 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 product. The FDA enforces the QSR through periodic inspections. We have been, and anticipate in the future being, subject to such inspections. Our failure, or the failure of our suppliers and subcontractors, to take satisfactory corrective action in response to an adverse QSR inspection 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, which would cause our sales and business to suffer.

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

To support the marketing of our products outside the United States, we must comply with and be certified to the ISO 13485: 2003 Quality Management System Standard. Failure to adequately maintain our ISO 13485: 2003 certifications may adversely impact or prevent the marketing of our products internationally. In markets where we sell through distributors, we primarily rely upon distributors to obtain all regulatory licenses, registrations and approvals required in countries outside of the United States, and these distributors may be unable to obtain or maintain such licenses, registrations and approvals. Our distributors may also incur significant costs in attempting to obtain and in maintaining regulatory licenses, registrations and approvals, which could increase the difficulty of attracting and retaining qualified distributors. If our distributors experience delays in receiving necessary licenses, registrations or approvals to market our products outside the United States, or if they fail to receive those licenses, registrations or approvals, we may be unable to market our products or product enhancements in international markets effectively, or at all.

### **Risks Related to Our Internal Control over Financial Reporting**

**While we believe we currently have adequate internal control over financial reporting, we are required to assess our internal control over financial reporting on an annual basis and any future adverse results from such assessment could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock.**

Pursuant to the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated by the SEC, we are required to maintain disclosure controls and procedures and adequate internal control over financial reporting. Under such requirements we must furnish in our Form 10-K a report by our management regarding the effectiveness of our internal control over financial reporting. The report includes, among other things, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management. While we currently believe our internal control over financial reporting is effective, the effectiveness of our internal controls in future periods is subject to the risk that our controls may become inadequate because of changes in conditions. The effectiveness of our controls and procedures may in the future be limited by a variety of factors, including:

faulty human judgment and simple errors, omissions or mistakes;

fraudulent action of an individual or collusion of two or more people;

inappropriate management override of procedures; and

the possibility that any enhancements to controls and procedures may still not be adequate to assure timely and accurate financial information.

If we are unable to assert that our internal control over financial reporting is effective in any future period, or if and when applicable, our auditors are unable to express an opinion on the effectiveness of our internal controls, or conclude that our internal controls are ineffective, or if we fail to maintain adequate and effective internal control over financial reporting, we could lose investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our stock price.

### **Risks Related to Our Common Stock**

**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. Our business typically has a short sales cycle, so that 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 in the foregoing risk factors. In light of these factors, and the uncertainty as a result of the general economic situation, it is difficult for us to estimate with accuracy our future results. Our expectations regarding these results will be subject to numerous risks and uncertainties that could make actual results differ materially from those anticipated. If our actual results do not meet our

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public guidance or our guidance or actual results do not meet the expectations of third-party financial analysts, our stock price could decline significantly.

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### **We expect that the price of our common stock will fluctuate substantially.**

The market price of our common stock is likely to be highly volatile and may fluctuate substantially due to many factors, including:

volume and timing of sales of our products;

the introduction of new products or product enhancements by us or our competitors;

disputes or other developments with respect to our intellectual property rights or the intellectual property rights of others;

our ability to develop, obtain regulatory clearance or approval for and market new and enhanced products on a timely basis;

product liability claims or other litigation;

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

sales of large blocks of our common stock, including sales by our executive officers and directors;

developments in our industry;

media exposure of our products or products of our competitors;

changes in governmental regulations or in the status of our regulatory approvals or applications;

changes in earnings estimates or recommendations by securities analysts; and

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

These and other factors may make the price of our stock volatile and subject to unexpected fluctuation.

### **A sale of a substantial number of shares of our common stock may cause the price of our common stock to decline.**

If our stockholders sell substantial amounts of our common stock in the public market, for example, liquidation of shares held by our principal stockholders, including shares issued upon the exercise of outstanding options, the market price of our common stock could decline. These sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem reasonable or appropriate.

### **Our directors, officers and principal stockholders have significant voting power and may take actions that may not be in the best interests of our other stockholders.**

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Our officers, directors and principal stockholders, some holding more than 5% of our common stock, collectively control approximately 37% of our outstanding common stock. As a result, these stockholders, if they act together, will be able to significantly influence the management and affairs of our company and most matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. This concentration of ownership may have the effect of delaying or preventing a change in control and might adversely affect the market price of our common stock. This concentration of ownership may not be in the best interests of our other stockholders.

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

Our 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;



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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.

### **We have a large number of authorized but unissued shares of stock, which could negatively impact a potential investor if they purchased our common stock.**

Our certificate of incorporation provides for 100,000,000 shares of authorized common stock, of which more than one-third of the shares are available for future issuance, and 10,000,000 shares of authorized preferred stock, all of which are available for future issuance. The issuance of additional shares of common stock may have a dilutive effect on earnings per share and relative voting power. We could use the shares of common stock that are available for future issuance in dilutive equity financing transactions, or to oppose a hostile takeover attempt or delay or prevent changes in control or changes in or removal of management, including transactions that are favored by a majority of the stockholders or in which the stockholders might otherwise receive a premium for their shares over then-current market prices or benefit in some other manner.

Our board of directors will be authorized, without further stockholder approval, to issue up to 10,000,000 shares of preferred stock with such rights, preferences and privileges as our board may determine. These rights, preferences and privileges may include dividend rights, conversion rights, voting rights and liquidation rights that may be greater than the rights of our common stock. As a result, the rights of holders of our common stock will be subject to, and could be adversely affected by, the rights of holders of any preferred stock that may be issued in the future.

### **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 your investment will only occur if our stock price appreciates.

## **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

## **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

## **ITEM 4. (REMOVED AND RESERVED)**

## **ITEM 5. OTHER INFORMATION**

None.

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### **ITEM 6. EXHIBITS**

<b>Exhibit No.</b>	<b>Description</b>
10.1 <sup>1</sup>	Fifth Amendment to Loan and Security Agreement between Solta Medical, Inc. and Silicon Valley Bank dated April 20, 2011.
31.1	Certification of Chief Executive Officer under Securities Exchange Act Rule 13a-14(a).
31.2	Certification of Chief Financial Officer under Securities Exchange Act Rule 13a-14(a).
32.1	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S. C. 1350 and Securities Exchange Act Rule 13a-14(b).
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Labels Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

<sup>1</sup> Incorporated by reference from our Current Report on Form 8-K filed with the Securities and Exchange Commission on April 25, 2011.

\* Pursuant to applicable securities laws and regulations, the Registrant is deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and is not subject to liability under any anti-fraud provisions of the federal securities laws as long as the Registrant has made a good faith attempt to comply with the submission requirements and promptly amends the interactive data files after becoming aware that the interactive data files fails to comply with the submission requirements. These interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act, are deemed not filed for purposes of section 18 of the Exchange Act and otherwise are not subject to liability under these sections.

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**SIGNATURES**

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

SOLTA MEDICAL, INC.

Date: August 3, 2011

/s/ Stephen J. Fanning  
Stephen J. Fanning  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: August 3, 2011

/s/ John F. Glenn  
John F. Glenn  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

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**INDEX TO EXHIBITS**

<b>Exhibit No.</b>	<b>Description</b>
10.1 <sup>1</sup>	Fifth Amendment to Loan and Security Agreement between Solta Medical, Inc. and Silicon Valley Bank dated April 20, 2011.
31.1	Certification of Chief Executive Officer under Securities Exchange Act Rule 13a-14(a).
31.2	Certification of Chief Financial Officer under Securities Exchange Act Rule 13a-14(a).
32.1	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S. C. 1350 and Securities Exchange Act Rule 13a-14(b).
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Labels Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

<sup>1</sup> Incorporated by reference from our Current Report on Form 8-K filed with the Securities and Exchange Commission on April 25, 2011.

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