Revance Therapeutics, Inc.
Form 4
February 10, 2016

FORM 4

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

OMB APPROVAL

OMB Number:	3235-0287
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STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
Ruegg Curtis

(Last) (First) (Middle)

C/O REVANCE THERAPEUTICS, INC., 7555 GATEWAY BOULEVARD

(Street)

NEWARK, CA 94560

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
Revance Therapeutics, Inc. [RVNC]

3. Date of Earliest Transaction (Month/Day/Year)
02/08/2016

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
EVP, Technical Operations

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	02/08/2016		M		1,000	A	$ 8.7	18,264	D	
Common Stock	02/08/2016		S (1)		1,000	D	$ 18.14 (2)	17,264	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8 D S (I
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares	
Employee Stock Option (Right to Buy)	$ 8.7	02/08/2016		M			1,000	(3)	05/26/2023	Common Stock	1,000	

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Ruegg Curtis C/O REVANCE THERAPEUTICS, INC. 7555 GATEWAY BOULEVARD NEWARK, CA 94560			EVP, Technical Operations	

Signatures

/s/ Gordon Ho, Attorney-in-fact	02/10/2016
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) The sales reported in this Form 4 were effected pursuant to a Rule 10b5-1 trading plan adopted by Dr. Ruegg on March 16, 2015.

(2) The price reported in Column 4 is a weighted average price. These shares were sold in multiple transactions at prices ranging from $18.00 to $18.25. Dr. Ruegg undertakes to provide to the Issuer, any security holder of the Issuer, or the staff of the Securities and Exchange Commission, upon request, full information regarding the number of shares sold at each separate price within the range.

(3) The shares subject to this Option vest in 48 equal monthly installments over 4 years following May 27, 2013.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
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# Indicates management contract or compensatory plan.

The Commission has granted confidential treatment to us with respect to certain omitted portions of this exhibit (indicated by asterisks). We have filed separately with the Commission an unredacted copy of the exhibit.

** Incorporated by reference to the same numbered exhibit filed with or incorporated by reference in our Registration Statement on Form S-1 (File No. 333-134086), dated December 19, 2006.

(1) In accordance with Rule 12b-12 of the Securities Exchange Act of 1934, this exhibit is an English translation of the original German document.

(2) Incorporated by reference to the same numbered exhibit filed with our Report on Form 10-Q, dated May 8, 2007.

(3) Incorporated by reference to the same numbered exhibit filed with our Report on Form 10-Q, dated August 10, 2007.

(4) Incorporated by reference to the same numbered exhibit filed with our Report on Form 10-Q, dated November 11, 2007.

(5) Incorporated by reference to Exhibit 10.1 filed with our Report on Form 8-K, dated September 24, 2007.

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(6) Incorporated by reference to Exhibit 10.1 filed with our Report on Form 8-K, dated September 21, 2007.

(7) Incorporated by reference to Exhibit 10.1 filed with our Report on Form 8-K, dated April 27, 2007.

(c) *Financial Statement Schedules*

The following financial statement schedule is filed as part of this Annual Report on Form 10-K:

Schedule Number	Description	Page
II	Valuation and Qualifying Accounts	106

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ARTES MEDICAL, INC.

By: /s/ Diane S. Goostree

Diane S. Goostree
President and Chief Executive Officer

Date: March 14, 2008

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Diane S. Goostree and Peter C. Wulff, jointly and severally, his or her attorneys-in-fact, each with the power of substitution, for him or her in any and all capacities, to sign any amendments to this report, and to file the same, with exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his or her substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature	Title(s)	Date
/s/ Diane S. Goostree Diane S. Goostree	President, Chief Executive Officer and Director (principal executive officer)	March 14, 2008
/s/ Peter C. Wulff Peter C. Wulff	Executive Vice President and Chief Financial Officer (principal financial and accounting officer)	March 14, 2008
/s/ Christopher J. Reinhard Christopher J. Reinhard	Executive Chairman of the Board of Directors	March 14, 2008
/s/ John R. Costantino John R. Costantino	Director	March 14, 2008
/s/ Lon E. Otremba Lon E. Otremba	Director	March 14, 2008

/s/ Beverly Huss	Director	March 14, 2008
Beverly Huss		
/s/ Robert Sherman	Director	March 14, 2008
Robert Sherman		
/s/ Todd C. Davis	Director	March 14, 2008
Todd C. Davis		

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Artes Medical, Inc.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Artes Medical, Inc.

We have audited the accompanying consolidated balance sheets of Artes Medical, Inc. as of December 31, 2007 and 2006 and the related consolidated statements of operations, stockholders equity and cash flows for each of the three years in the period ended December 31, 2007. Our audits also included the financial statement schedule listed in the Index at Item 15(c). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Artes Medical, Inc. at December 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, Artes Medical, Inc. changed its method of accounting for share-based payments in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004) on January 1, 2006.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As more fully described in Note 1, the Company has recurring operating losses, an accumulated deficit of $106.3 million and working capital of $16.5 million at December 31, 2007. These factors, among others, as discussed in Note 1 to the consolidated financial statements, raise substantial doubt about the Company s ability to continue as a going concern. Management s plans in regard to these matters are also described in Note 1. The 2007 consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the outcome of this uncertainty.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Artes Medical, Inc. s internal control over financial reporting as of December 31, 2007, based upon criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 13, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Diego, California
March 13, 2008

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Artes Medical, Inc.

Consolidated Balance Sheets

	December 31, 2007	December 31, 2006
	(In thousands, except share and per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 20,293	$ 46,258
Accounts receivable (net of allowance for doubtful accounts of $20 and $0 at December 31, 2007 and December 31, 2006, respectively)	792	
Prepaid expenses	754	304
Inventory, net	5,528	4,761
Other assets	290	102
Total current assets	27,657	51,425
Property and equipment, net	5,034	5,271
Intellectual property, net	2,385	3,578
Deposits and other assets	645	339
Total assets	$ 35,721	$ 60,613
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,880	$ 2,218
Accrued compensation and benefits	1,802	1,774
Accrued severance		920
Accrued expenses	1,194	690
Income taxes payable		73
Capital lease obligations, current portion	21	45
Revolving credit line	5,000	5,000
Term note payable, current portion	1,250	1,250
Deferred rent, current portion	21	49
Total current liabilities	11,168	12,019
Term note payable (net of discount of $165 and $305 at December 31, 2007 and 2006, respectively)	2,231	3,341
Capital lease obligations, less current portion		21
Deferred rent, less current portion	783	678
Deferred tax liability	915	1,368
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.001 par value 200,000,000 shares authorized at December 31, 2007 and 2006; 16,514,163 and 16,361,246 shares issued and outstanding at	17	16

December 31, 2007 and 2006, respectively		
Additional paid-in capital	126,894	122,572
Accumulated deficit	(106,287)	(79,402)
Total stockholders equity	20,624	43,186
Total liabilities and stockholders equity	$ 35,721	$ 60,613

See accompanying notes.

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Artes Medical, Inc.

Consolidated Statements of Operations

	Years Ended December 31,		
	2007	2006	2005
	(In thousands, except share and per share data)		
Revenues:			
Product sales	$ 7,084	$	$
License revenues	6,232	390	
Total revenues	13,316	390	
Cost of product sales	10,659		
Gross profit	2,657	390	
Operating expenses:			
Research and development	6,023	8,084	10,189
Selling, general and administrative	24,331	17,299	10,137
Loss from operations	(27,697)	(24,993)	(20,326)
Interest income	1,391	675	52
Interest expense	(1,119)	(2,454)	(4,468)
Other income (expense), net	(2)	(27)	2,041
Loss before benefit for income taxes	(27,427)	(26,799)	(22,701)
Benefit for income taxes	542	476	458
Net loss	$ (26,885)	$ (26,323)	$ (22,243)
Loss per share:			
Basic and diluted	$ (1.63)	$ (14.23)	$ (18.76)
Weighted average shares basic and diluted	16,462,369	1,850,255	1,185,387

See accompanying notes.

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Artes Medical, Inc.

Consolidated Statements of Stockholders Equity (Deficit)

	Convertible Preferred Shares	Stock Amount	Common Shares	Common Stock Amount	Common Stock Issuable	Convertible Preferred Stock Subscribed	Additional Paid-In Capital	Deferred Stock-Based Compensation	Accumulated Deficit	St
December 31,	7,167,819	$ 7	1,138,644	$ 1		$ 3,543	$ 23,322	$ (631)	$ (30,836)	S
common stock se of stock March			5,882				25			
common stock se of options s			23,731				120			
common stock rendered in gh December			51,528				386			
common stock on with agreement in			9,768				102			
ock issuable in or guarantee on debt in					735					
Series D ock in exchange ble notes and erest, and cash, $2.00 per share, nce costs	9,754,761	10				(3,543)	14,245			
Series D ock at $2.00 in or services in	265,096						367			
warrants in with Series D preferred stock							809			
warrants in with note payable in ough September							2,007			
							276			

warrants in with of convertible cember Series E ock for cash, in 2005, at $2.50 et of issuance	3,089,615	3					7,703		
eferred stock ns at $2.50 per sh in December						6,900			
Series E ock at $2.50 per change for agreement in	124,000						310		
Series E ock at $2.50 per change for of convertible e in December	250,000						625		
d compensation							959		
ock on							2,383	(2,383)	
on of deferred on								335	
d sive loss									(22,243)
December 31,	20,651,291	20	1,229,553	1	735	6,900	53,639	(2,679)	(53,079)
common stock se of warrants ptions			114,506				440		
common stock in January y			8,048				89		
common stock on with property in			4,705				49		
Series E preferred stock r share for cash, net of issuance	3,994,000	4				(6,750)	9,367		
Series E preferred stock r share for cash, , net of issuance	5,484,200	6				(150)	12,444		

Series E preferred stock share for cash, et of issuance	7,712,406	8					16,888			
Series C-1 preferred stock se of warrants May	50,000						50			
common stock on with n convertible			70,588		(735)		735			
common stock public offering			5,290,000	5			25,279			
warrants upon c offering			276,334				583			
warrants to eries E preferred stock on with greement							253			
of convertible ock upon initial ing	(37,891,897)	(38)	9,367,512	10			28			
n of vesting of ctor stock n initial public							547			
l compensation							2,526			
l severance							958			
ock on							(2,679)	2,679		
odification							1,376			
l sive loss									(26,323)	
December 31,		$	16,361,246	$ 16	$	$	$ 122,572	$	$ (79,402)	$
common stock se of warrants ptions			152,917	1			535			
c offering cost							(14)			
l compensation							3,238			
ock on							563			
l sive loss									(26,885)	

December 31,	$ 16,514,163	$ 17	$	$	$ 126,894	$	$ (106,287)	$

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Artes Medical, Inc.

Consolidated Statements of Cash Flows

	Years Ended December 31,		
	2007	**2006**	**2005**
		(In thousands)	
Operating activities			
Net loss	$ (26,885)	$ (26,323)	$ (22,243)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	2,653	2,428	1,742
Bad debt expense	72		
Benefit for income taxes	(453)	(478)	(458)
Non-cash interest expense associated with issuance of warrants and convertible notes	140	2,350	4,308
Warrant modification expense		899	
Stock-based compensation	3,801	4,032	1,294
Issuance of stock for services		90	558
Issuance of stock for settlement and termination agreements			412
Issuance of common stock for intellectual property		49	
Loss on disposal of fixed assets		43	
Deferred rent	77	42	200
Deferred taxes			(27)
Changes in operating assets and liabilities:			
Accounts receivable	(864)		
Inventory	(767)	(4,070)	(442)
Prepaid expenses and other assets	(638)	172	(208)
Accounts payable	(336)	(1,099)	(398)
Accrued compensation and benefits	28	275	1,346
Accrued severance	(920)	920	
Accrued expenses	504	(896)	834
Income taxes payable	(73)	3	27
Net cash used in operating activities	(23,661)	(21,563)	(13,055)
Investing activities			
Acquisition of intellectual property, net of cash acquired			(2,250)
Purchases of property and equipment	(1,223)	(1,623)	(4,554)
Deposits and other assets	(306)	(3,156)	(950)
Net cash used in investing activities	(1,529)	(4,779)	(7,754)
Financing activities			
Proceeds from term loan payable		4,945	
Payments on term loan payable	(1,251)	(104)	
Payments on revolving line of credit	(476)		

Proceeds from revolving credit line	476	5,000	
Proceeds from issuance of convertible notes payable			6,970
Payments on convertible notes payable		(6,525)	
Proceeds from capital lease obligations			157
Payments on capital lease obligations	(45)	(49)	(41)
Proceeds from subscribed preferred stock			6,900
Proceeds from issuance of preferred stock, net		31,816	11,456
Proceeds from issuance of common stock	(14)	29,513	
Proceeds from exercise of stock options and warrants	535	1,074	28
Net cash (used in) provided by financing activities	(775)	65,670	25,470
Net (decrease) increase in cash and cash equivalents	(25,965)	39,328	4,661
Cash and cash equivalents at beginning of year	46,258	6,930	2,269
Cash and cash equivalents at end of year	$ 20,293	$ 46,258	$ 6,930
Noncash financing activities			
Issuance of subscribed preferred stock	$	$ 6,900	$ 3,543
Issuance of warrants and common stock in connection with intellectual property acquisition	$	$ 49	$
Conversion of convertible notes and interest into convertible preferred stock	$	$	$ 8,246
Issuance of convertible notes payable as commission for financing	$	$	$ 203
Conversion of payables to convertible notes payable	$	$	$ 95
Supplemental activities			
Cash paid for income taxes	$ 1	$ 1	$ 1
Cash paid for interest	$ 979	$ 104	$ 160

See accompanying notes.

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Artes Medical, Inc.

Notes to Consolidated Financial Statements

1. Organization and Summary of Significant Accounting Policies

Organization and Business

Artes Medical, Inc., (the Company), formerly known as Artes Medical USA, Inc., was incorporated in Delaware on August 24, 1999, and is focused on the development, manufacture and commercialization of a new category of injectable aesthetic products for the dermatology and plastic surgery markets, principally in the United States. The Company s initial product, ArteFill, is a non-resorbable aesthetic injectable implant for the correction of facial wrinkles known as smile lines, or nasolabial folds. The Company received FDA approval to market ArteFill on October 27, 2006 and commenced commercial shipments of ArteFill during the first quarter of 2007. Prior to 2007, the Company was a development stage company. Since inception, and through December 31, 2007, the Company has an accumulated deficit of $106.3 million.

Basis of Presentation and Management s Plan

The Company has a history of recurring losses from operations and has an accumulated deficit of $106.3 million as of December 31, 2007. As of December 31, 2007, the Company had available cash and cash equivalents totaling $20.3 million and working capital of $16.5 million. Additionally, the Company will require additional cash funding to execute against its strategic plan for 2008. These factors raise substantial doubt about the Company s ability to continue as a going concern. The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. This basis of accounting contemplates the recovery of the Company s assets and the satisfaction of liabilities in the normal course of business and this does not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

A successful transition to attaining profitable operations is dependent upon obtaining additional financing adequate to fulfill its planned expenses and achieving a level of revenues adequate to support the Company s cost structure. In addition to the net amounts raised from Cowen Healthcare Royalty Partners, L.P. in January 2008 (See Note 12), the Company intends to seek additional debt or equity financing to support its operations until it becomes cash flow positive. There can be no assurances that there will be adequate financing available to the Company on acceptable terms or at all. If the Company is unable to obtain additional financing, or cannot achieve its forecasted sales during 2008, the Company would need to significantly curtail or reorient its operations during 2008, which could have a material adverse effect on the Company s ability to achieve its business objectives.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and Artes Medical Germany GmbH. All intercompany accounts have been eliminated in consolidation.

In June 2007, the Company announced the formation of a new wholly-owned subsidiary named Spheris Medical, Inc. to develop and commercialize new and innovative therapeutic medical applications of its proprietary microsphere tissue bulking technology through collaborative agreements with third parties. As of December 31, 2007, there were no tangible assets or accounting transactions involving Spheris Medical, Inc.

Reverse Stock Split, Conversion to Common Stock and Initial Public Offering

In connection with the Company s initial public offering, the Company effected a 1-for-4.25 reverse stock split of its common stock on December 19, 2006. In addition to the reverse stock split, all outstanding shares of the Company s preferred stock were converted to common stock immediately prior to the closing of the Company s initial public offering on December 26, 2006. Each outstanding share of Series A, Series D and Series E preferred stock was converted into one share of common stock, and as a result of anti-dilution provisions, each share of Series B preferred stock was converted into 1.35 shares of common stock and each share of Series C-1 preferred stock was converted into 1.375 shares of common stock. On December 26, 2006, after giving effect to the 1-for-4.25

Artes Medical, Inc.

Notes to Consolidated Financial Statements (Continued)

reverse stock split, and the anti-dilution provisions associated with the Series B and C-1 preferred stock, all of the outstanding shares of preferred stock were automatically converted into 9,367,512 shares of common stock. In addition, as a result of the conversion to common stock, all warrants or other rights to purchase the Company s preferred stock outstanding on December 26, 2006 were automatically converted into the right to purchase shares of common stock at the applicable conversion ratios for the particular series of preferred stock. The actions necessary to effect the reverse stock split and the conversion of the preferred stock to common stock were approved by the Company s Board of Directors and the required vote of the Company s stockholders.

The accompanying consolidated financial statements and related notes give retroactive effect to the reverse stock split for all periods presented with respect to outstanding shares of common stock and options and warrants exercisable for common stock. The accompanying consolidated financial statements and related notes do not reflect the conversion to common stock (or the reverse stock split) for all periods presented with respect to outstanding shares of preferred stock and warrants exercisable for preferred stock.

On December 26, 2006, the Company closed an initial public offering of its common stock in which it sold 5,290,000 shares of common stock for gross proceeds of $31.7 million. After underwriting discounts, commissions and other offering expenses, the Company received net proceeds of $25.3 million from this offering.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation. License revenues from the year ended December 31, 2006 have been reclassified to license revenues in the 2007 statement of operations instead of other income and certain balance sheet accounts have been combined.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of less than three months when purchased to be cash equivalents.

Revenue Recognition

The Company follows the provisions of the Securities and Exchange Commission Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*, which sets forth guidelines for the timing of revenue recognition based upon factors such as passage of title, installation, payment and customer acceptance. The Company recognizes revenue from product sales when all four of the following criteria are met: (i) there is persuasive evidence that an arrangement exists, (ii) delivery of the product has occurred and title has transferred to its customers, (iii) the selling price is fixed and determinable and (iv) collection is reasonably assured. Provisions for discounts to customers or other adjustments are recorded as a reduction of revenue and provided for in the same period that the related product sales are recorded

based upon analysis of historical discounts and exchanges.

The Company recognizes revenue when its products have reached the destination point and other criteria for revenue recognition have been met.

A substantial amount of business is transacted using credit cards. The Company may offer an early payment discount to certain customers.

The Company has a no return policy for its product except in the case of product that may be shipped in error or damaged in shipment. During 2007, the Company shipped product to customers which did not provide for sufficient

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Artes Medical, Inc.

Notes to Consolidated Financial Statements (Continued)

shelf life for certain customers to utilize the product before expiration. As a result, the Company exchanged product that was going to expire for product with sufficient shelf life to be utilized by the customers. These exchanges were substantially completed by December 31, 2007. At December 31, 2007, the Company had a sales reserve of $150,000 for exchanges which were completed in early 2008. During the last half of 2007, the Company refined its shipping policies to eliminate the shipment of product without adequate shelf life.

Allowance for Doubtful Accounts

The Company determines its allowance for doubtful accounts based on an analysis of the collectibility of accounts receivable, historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in customer payment terms. The expense related to the allowance for doubtful accounts is recorded in selling, general and administrative. The Company does not write off individual accounts receivable until all avenues of legal recourse to collect the outstanding amount have been exhausted.

Valuation of Inventory

Inventories are stated at the lower of cost or market, with cost being determined under a standard cost method, which approximates a first-in, first-out basis. The Company s inventories are evaluated and any non-usable inventory is expensed. In addition, the Company reserves for any inventory that may be excess or potentially non-usable. Charges for such write-offs and reserves are recorded as a component of cost of sales.

Fair Value of Financial Instruments

The carrying amount of cash, accounts receivable, accounts payable, and accrued liabilities are considered to be representative of their respective fair values because of the short-term nature of those instruments. The Company believes the carrying amount of the notes payable approximate their respective fair values.

Concentration of Credit Risk

Financial instruments, which potentially subject the Company to significant concentration of credit risk, consist primarily of cash and cash equivalents. The Company maintains deposits in federally insured financial institutions in excess of federally insured limits. Management believes that the Company is not exposed to significant credit risk due to the financial position of the depository institutions in which those deposits are held. The Company s customers are primarily physicians and no single customer represents more than 10% of revenues for any period presented. Credit to customers is granted based on analysis of customers credit worthiness and credit losses have not been significant.

Property and Equipment

Property and equipment are stated at cost and depreciated over the estimated useful lives of the assets (three to seven years) using the straight-line method. Leasehold improvements are amortized over the lesser of the term of the related lease or the useful life of the asset.

Impairment of Long-Lived Assets

Long-lived assets consist of property and equipment and intellectual property. In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company will record impairment losses on long-lived assets used in operations when events and circumstances indicate that assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those assets. While the Company s current and historical operating losses and cash flows are indicators of impairment, the Company believes the future cash flows to be received

Artes Medical, Inc.

Notes to Consolidated Financial Statements (Continued)

support the carrying value of its long-lived assets and, accordingly, the Company has not recognized any impairment losses through December 31, 2007.

Deferred Rent

Rent expense is recorded on a straight-line basis over the term of the lease. The difference between rent expense and amounts paid under the lease agreements is recorded as deferred rent in the accompanying consolidated balance sheets. Landlord construction allowances and other such lease incentives are recorded as deferred rent and are amortized on a straight-line basis as a reduction to rent expense.

Patent Costs

Costs related to filing and pursuing patent applications are expensed as general and administrative expenses as incurred since recoverability of such expenditures is uncertain.

Research and Development Expenses

Research and development costs are expensed as incurred and such costs consist primarily of costs to further the Company s research and development activities and include compensation and other expenses for research and development personnel, costs associated with clinical trials, non-clinical activities, process development activities, regulatory activities, supplies and development materials, costs for consultants, research-related overhead expenses, amortization of purchased technology, and depreciation.

Shipping and Handling Costs

Shipping and handling costs are classified in cost of product sales.

Advertising

Advertising costs are expensed as incurred and included in sales and marketing expenses. Advertising expenses include external advertising and promotional literature. Advertising expenses were $573,000, $119,000 and $37,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

Sales Taxes

Sales and other taxes collected from customers and subsequently remitted to government authorities are recorded as accounts receivable with a corresponding offset recorded to sales tax payable. These balances are removed from the consolidated balance sheet as cash is collected from the customers and remitted to the tax authority.

Income Taxes

The Company uses the liability method of accounting for income taxes as required by SFAS No. 109, *Accounting for Income Taxes.*

Under this method, deferred tax assets and liabilities are determined based on the difference between the financial reporting and the tax reporting basis of assets and liabilities and are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. The Company provides a valuation allowance against net deferred tax assets unless, based upon the available evidence, it is more likely than not that the deferred tax assets will be realized.

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Notes to Consolidated Financial Statements (Continued)

Foreign Currency Translation and Transactions

The financial statements of foreign subsidiaries are denominated in local currency and are then remeasured into U.S. dollars as the U.S. dollar is the functional currency. The remeasurement of local currency amounts into U.S. dollars creates translation adjustments that are included as Other Expenses in the Statements of Operations for the applicable period. Transaction and translation gains or losses were not material to the financial statements for any periods presented.

Stock-based Compensation

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment* (SFAS No. 123(R)) using the prospective transition method, and therefore, prior period results have not been restated. SFAS No. 123(R), which revises SFAS No. 123, *Accounting for Stock-Based Compensation* and (SFAS No. 123), supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), and related interpretations. Under this transition method, the compensation cost related to all equity instruments granted prior to, but not yet vested as of, the adoption date is recognized based on the grant-date fair value which is estimated in accordance with the original provisions of SFAS No. 123. Compensation costs related to all equity instruments granted after January 1, 2006 is recognized at the grant-date fair values of the awards in accordance with the provisions of SFAS No. 123(R). Additionally, under the provisions of SFAS No. 123(R), the Company is required to include an estimate of the number of awards that will be forfeited in calculating compensation costs, which is recognized over the requisite service period of the awards on a straight-line basis.

For purposes of calculating the stock-based compensation under SFAS 123(R), the Company estimates the fair value of stock options using a Black-Scholes option-pricing model which is consistent with the model used for pro forma disclosures under SFAS 123 prior to the adoption of SFAS 123(R). The Black-Scholes option-pricing model incorporates various and highly sensitive assumptions including expected volatility, expected term and interest rates. In accordance with SFAS 123(R) share-based compensation expense recognized in the statement of operations is based on awards ultimately expected to vest and is reduced for estimated forfeitures. Prior to the adoption of SFAS 123(R), the Company used the minimum value method for valuing stock options granted to employees and directors. For periods prior to 2006, the Company accounted for forfeitures as they occurred.

The assumptions used to estimate the fair value of stock options granted to employee and directors during the years ended December 31, 2007, 2006 and 2005 are as follows:

	Years Ended December 31,		
	2007 Actual	**2006 Actual**	**2005 Pro Forma**
Volatility	48%	60%	0%
Expected term (years)	6.0	6.0	4.0
Risk free interest rate	4.75%	4.55%	3.00% 4.50%
Expected dividend yield	0%	0%	0%
Forfeiture rate	14%	14%	4%

The risk-free interest rate assumption was based on the United States Treasury s rates for U.S. Treasury zero-coupon bonds with maturities similar to those of the expected term of the award being valued. The assumed dividend yield was based on the Company s expectation of not paying dividends in the foreseeable future. The weighted average expected life of options was calculated using the simplified method as prescribed by the SEC s SAB No. 107 (SAB No. 107). This decision was based on the lack of relevant historical data due to the Company s limited historical experience. In addition, due to the Company s limited historical data, the estimated volatility also reflects the application of SAB No. 107, incorporating a combination of the historical volatility of comparable companies whose share prices are publicly available and the Company s historical volatility. The estimated

Artes Medical, Inc.

Notes to Consolidated Financial Statements (Continued)

forfeiture rate is based on historical data for forfeitures and the Company is recognizing compensation expense only for those equity awards expected to vest.

The weighted average grant-date fair value of stock options granted during the years ended December 31, 2007 and 2006 was $7.58 and $8.00 per share, respectively.

During the year ended December 31, 2007, the Company recorded approximately $3,238,000 of stock-based compensation expense. Of this amount, $403,000 has been capitalized to inventory, $336,000 is included in research and development expenses and $2,499,000 is included in selling, general and administrative expenses. During the year ended December 31, 2006, the Company recorded approximately $1,300,000 of stock-based compensation expense. Of this amount, $146,000 has been capitalized to inventory, $139,000 is included in research and development expenses and $1,015,000 is included in selling, general and administrative expenses.

Total unrecognized stock-based compensation costs related to non-vested stock options granted during the year ended December 31, 2007 was approximately $6,403,000, which related to 3,181,958 options issued and outstanding. This unrecognized cost is expected to be recognized on a straight-line basis over a weighted average period of approximately four years.

Equity instruments issued to non-employees are recorded at their fair values as determined in accordance with SFAS 123, *Accounting for Stock-Based Compensation*, and Emerging Issues Task Force (EITF) 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods and Services*, and are periodically revalued as the options vest and are recognized as expense over the related service period. The Company recorded stock-based compensation for options granted to non-employees of $245,000, $156,000, $107,000 for the years ended December 31, 2007, 2006 and 2005, respectively. The fair value of each option was determined using the Black-Scholes valuation model and periodically re-measured and recognized over the related service period.

During the years ended December 31, 2007, 2006, 2005, the Company recognized $245,000, $535,000 and $959,000, respectively, for stock options and warrants issued to non-employees.

Deferred Stock-Based Compensation

No employee related stock-based compensation expense was reflected in the Company s reported net loss in any period prior to 2004, as all options granted to employees had an exercise price equal to the estimated fair value of the underlying common stock on the date of the grant. Stock-based compensation was recognized in 2004 for warrants granted to a member of the Board of Directors as the exercise price of the warrants was less than the estimated fair value of the underlying common stock on the date of grant.

On September 13, 2005, the Company commenced the initial public offering process, and based on discussions with its investment bankers, reassessed the fair value of its common stock going back to July 1, 2004. The Company s management, all of whom qualify as related parties, determined that the stock options granted from July 1, 2004 forward were granted at exercise prices that were below the reassessed fair value of the common stock on the date of grant. The Company completed the reassessment of its fair value without the use of an unrelated valuation specialist and started with the proposed valuation from its investment bankers, considering a number of accomplishments in

2004 and 2005 that would impact its valuation, including achievement of key clinical milestones, hiring executive officers, and the increased possibility of completing an initial public offering. Accordingly, deferred stock-based compensation of $740,000 was recorded within Stockholders Equity (deficit) during 2004 which represented the difference between the weighted-average exercise price of $4.25 and the weighted-average fair value of $6.38 on 324,705 options granted to employees during 2004. Deferred stock-based compensation of $2,383,000, net of forfeitures, was recorded within Stockholders Equity during 2005 which represented the difference between the weighted-average exercise price of $5.31 and the weighted-average fair value of $9.18 on 620,000 options granted to employees during 2005.

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Notes to Consolidated Financial Statements (Continued)

The deferred stock-based compensation is being amortized on a straight-line basis over the vesting period of the related awards, which is generally four years.

During the years ended December 31, 2007, 2006 and 2005, the Company recognized $563,000, $719,000, and $335,000, respectively, in amortization of deferred stock-based compensation which was provided for prior to the adoption of SFAS 123(R).

Unrecognized deferred stock-based compensation related to non-vested stock option and warrant awards granted prior to January 1, 2006 was approximately $800,000 at December 31, 2007.

The expected future amortization expense for deferred stock-based compensation for stock options granted through December 31, 2007, is as follows (in thousands):

2008	$ 463
2009	337
Total	$ 800

Upon the adoption of SFAS No. 123(R) on January 1, 2006, deferred stock-based compensation was reclassified against additional paid-in capital.

The stock-based compensation expense that has been included in the statement of operations for all stock-based compensation arrangements was as follows:

	Years Ended December 31,		
			Pro Forma
	2007	2006	2005
	(In thousands, except per share amounts)		
Capitalized to inventory	$ 575	$ 263	
Research and development expense	$ 453	$ 766	$ 256
Sales, general and administrative expense	2,773	4,165	1,092
	$ 3,226	$ 4,931	$ 1,348
Net effect on basic and diluted net loss per share	$ 0.20	$ 2.67	$ 1.14

Recently Issued Accounting Standards

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Management has not yet completed its evaluation of the impact of adopting SFAS No. 157.

On February 15, 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS No. 159 permits all entities to choose, at specified election dates, to measure eligible items at fair value (the fair value option). A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted. The Company is currently evaluating whether SFAS No. 159 will have a material effect on its consolidated financial statements.

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Notes to Consolidated Financial Statements (Continued)

2. Net Loss Per Common Share

Basic net loss per common share is calculated by dividing the net loss by the weighted-average number of common shares outstanding for the period, without consideration for common stock equivalents. Diluted net loss per common share is computed by dividing the net loss by the weighted-average number of common share equivalents outstanding for the period determined using the treasury-stock method. For purposes of this calculation, convertible preferred stock, stock options and the outstanding warrants are considered to be common stock equivalents and are only included in the calculation of diluted net loss per share when their effect is dilutive.

Historical outstanding anti-dilutive securities not included in the diluted net loss per common calculation:

	December 31,		
	2007	**2006**	**2005**
Convertible preferred stock			5,307,180
Warrants to purchase preferred and common stock	2,470,638	2,530,336	2,423,758
Options to purchase common stock	3,181,958	2,133,842	1,149,000
	5,652,596	4,664,178	8,879,938

3. Acquisitions

MediPlant Acquisition Settlement Agreement

In October 2005, the Company, FormMed Biomedicals AG, and Dr. Martin Lemperle, one of the Company s founders, entered into a settlement agreement to accelerate two installment payments due under a purchase agreement dated July 22, 2004, and to settle and mutually release all parties regarding reimbursement of certain production and development costs incurred by FormMed prior to the date of the purchase agreement and reimbursement to Dr. Martin Lemperle of certain legal expenses. Upon final settlement of the litigation with one of the Company s competitors (see Note 5) and receipt of the settlement amount in 2005, the Company paid FormMed $750,000 as the final payment and secured the release of certain tangible and intangible assets held in escrow, as required pursuant to the terms of the original MediPlant purchase agreement.

The Company paid FormMed 428,000 Euro for the prior production and development costs on a payment schedule through June 30, 2006. In addition, the Company issued FormMed 7,214 shares of Company common stock as consideration for accrued interest. The Company paid Dr. Martin Lemperle 150,000 Euro in 2006 for all legal costs incurred as a result of the settlement and litigation agreements with a competitor (see Note 5). In addition, the Company issued Dr. Martin Lemperle 2,549 shares of Company common stock as consideration for accrued interest.

All parties agreed that both the cash payments and common stock grant covers in full all prior period production, development and legal costs incurred by FormMed and Dr. Martin Lemperle.

4. License Agreement

On September 21, 2007, the Company entered into a Second License Agreement (the Second Agreement) with BioForm Medical, Inc. and BioForm Medical Europe B.V. (together, BioForm). Under the Second Agreement, BioForm elected to pre-pay all future royalty obligations to the Company by making two payments totaling $5.5 million. These payments replaced any future royalty obligation of BioForm to the Company under the Settlement and License Agreement, dated October 31, 2005.

The Company recognized license revenue of $5.5 million related to this agreement in the third quarter of 2007.

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Notes to Consolidated Financial Statements (Continued)

5. Balance Sheet Details

Inventory

Inventory consists of raw materials used in the manufacture of ArteFill, work in process and finished good ready for sale. Inventory is carried at the lower of cost or market. Cost is determined using a standard cost method, which approximates a first-in, first-out basis, with provisions made for obsolete or slow moving goods.

Inventory consisted of the following (in thousands):

	December 31,	
	2007	**2006**
Raw materials	$ 1,147	$ 727
Work in process	2,462	1,619
Unpackaged finished goods	3,555	3,169
Finished goods	602	
	7,766	5,515
Less: reserve for excess and obsolete inventory	(2,238)	(754)
Total	$ 5,528	$ 4,761

Property and Equipment

Property and equipment consisted of the following (in thousands):

		December 31,	
	Useful Lives	**2007**	**2006**
Furniture and fixtures	7 years	$ 625	$ 588
Office equipment	3 - 5 years	949	734
Lab equipment	3 - 5 years	2,726	2,464
Leasehold improvements	Life of lease	4,050	3,351
		8,350	7,137
Less accumulated depreciation and amortization		(3,316)	(1,866)
Total		$ 5,034	$ 5,271

As of December 31, 2007 and 2006, lab equipment and office equipment includes approximately $130,000 and $130,000, respectively, of equipment financed under capital leases with accumulated depreciation of approximately $109,000 and $46,000, respectively.

Total depreciation expense, which includes amortization of assets recorded under capital leases, for the years ended December 31, 2007, 2006 and 2005 was $1,460,000, $1,235,000, and $549,000, respectively.

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Notes to Consolidated Financial Statements (Continued)

Intellectual Property

Intellectual property consisted of the following (in thousands):

	December 31, 2007			December 31, 2006		
	Gross	Accumulated Amortization	Net Book Value	Gross	Accumulated Amortization	Net Book Value
Patents	$ 287	$ 192	$ 95	$ 287	$ 144	$ 143
Core technology	6,868	4,578	2,290	6,868	3,433	3,435
Total	$ 7,155	$ 4,770	$ 2,385	$ 7,155	$ 3,577	$ 3,578

Patents and core technology are amortized over a useful life of six years. Amortization expense was $1,193,000 for each of the years ended December 31, 2007, 2006 and 2005. Amortization expense for patents and core technology is estimated to be $1,193,000 for each of 2008 and 2009.

6. Commitments and Contingencies

On November 27, 2006, the Company entered into a loan and security agreement with Comerica Bank, pursuant to which the Company obtained a credit facility with Comerica Bank, consisting of a revolving line of credit in the amount of up to $5,000,000 and a term loan in the amount of up to $5,000,000. Interest on the revolving line and the term loan accrues at prime plus 2%. The revolving line and term loan mature on November 27, 2008 and 2010, respectively. The agreement requires the Company to meet certain liquidity ratios and imposes certain restrictions on mergers, acquisitions and distributions. In addition the Company granted the bank a warrant to purchase 120,000 shares of Series E preferred stock at an exercise price of $2.50 per share. The fair value of the warrant plus the related beneficial conversion feature totaled $253,000; this amount plus an additional $54,000 of actual loan costs was recorded as debt discount and will be amortized over the life of the term loan using the effective interest method. The debt is secured by substantially all of the assets of the Company.

The following is a summary of the credit facility at December 31, 2007 (in thousands):

Comerica Bank revolving line of credit	$ 5,000
Comerica Bank term loan	3,646
	8,646
Less current portion	6,250
	2,396
Debt discount	(165)

Long-term debt	$ 2,231

In February 2008, the Company repaid and terminated its credit facilities with Comerica Bank.

The Company leases equipment under various equipment financing arrangements which expire in 2008 and have interest rates ranging from 8.5% to 9.3%.

In June 2007, the Company has a master service agreement with Therapeutics, Inc., an independent clinical research organization, to conduct clinical studies for the Company, including the 5-year post-approval safety study required by the FDA as part of its approval of ArteFill. Therapeutics Inc. will conduct project management, medical monitoring, case reports, subject recruitment, data analysis and other clinical study activities for clinical studies the Company initiates or that are conducted by third parties under a grant the Company provides to the third parties.

In August 2007, the Company entered into a supply agreement with Lampire Biological Labs, Inc. for bovine corium, which the Company uses to produce its highly purified and partly denatured bovine collagen contained in ArteFill. Under the terms of this agreement, pricing is based on unit fees for the acquisition of calves and for

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Notes to Consolidated Financial Statements (Continued)

processing. Lampire has agreed to process the bovine corium in strict accordance with general and manufacturing process requirements to ensure safety and quality, and to ensure that the bovine collagen is free from BSE. The agreement requires that the Company purchase at least $612,000 of bovine corium during the one-year term.

In August 2007, the Company entered into an amended and restated building lease agreement for the 35,000 square foot corporate, manufacturing and research and development headquarters in San Diego, California with the new owner of the facilities, Biomed Realty, L.P. Under the amended and restated lease, the Company extended the existing lease term from December 2011 to December 2012, maintained the Company s option to extend the lease term for an additional 5-year period and extended the Company s current right of first refusal to include the property adjacent to this property that the Company leases for additional office space.

Also in August 2007, the Company entered into a building lease agreement with Biomed Realty, L.P. for 32,000 square feet of office space in a building adjacent to the Company s headquarters in San Diego, California. The Company had previously subleased 8,000 square feet in this building. The lease expires in December 2012. The Company has a first right of refusal to purchase the facility during the term of the lease, as well as the right to extend the lease term for an additional 5-year period. The landlord has also extended the Company a $1.14 million tenant improvement allowance. The building will be used for general office administration, research and development labs and outbound distribution.

In addition, the Company leases a 3,550 square foot manufacturing and warehouse facility in Frankfurt, Germany, where the Company manufactures the PMMA microspheres used exclusively in ArteFill. The leases for the Company s Frankfurt facility expire in November 2008, and are subject to automatic one-year extensions unless written notice of termination is given by either party at least six months prior to the beginning of the extension term.

Future annual minimum rental payments under the Company s operating leases are as follows (in thousands):

Years ended December 31, 2008	1,487
2009	1,556
2010	1,626
2011	1,696
2012	1,769
Total minimum lease payments	$ 8,134

The Company s leases include annual escalations in base rent and rent abatements. Rent expense was $1,097,000, $919,000, $954,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

In August 2007, the Company entered into a Severance Protection Agreement with Diane S. Goostree, President and Chief Executive Officer and Change of Control Agreements with the following named executive officers: Christopher J. Reinhard, Peter C. Wulff and Larry J. Braga, and with the following executive officers: Karla R. Kelly, J.D., Russell J. Anderson, Susan A. Brodsky-Thalken, Frank M. Fazio and Greg Kricorian, M.D. Under these agreements, the Company is obligated to make certain severance payments to these individuals in the event their employment is

terminated under certain circumstances.

In March 2008, the Company entered into Change of Control Agreements with John Kay, Ph. D. and Karon J. Morell. Under these agreements, the Company is obligated to make certain severance payments to these individuals in the event their employment with the Company is terminated under certain circumstances.

The Company is subject to various legal actions and proceedings in the normal course of business. While the ultimate outcome of these matters cannot be predicted with certainty, management does not believe these matters will have a material adverse effect on the Company s financial statements.

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Notes to Consolidated Financial Statements (Continued)

Litigation Settlement Agreement

On October 31, 2005, the Company and Dr. Martin Lemperle, one of the Company s founders, resolved all of their outstanding disputes and litigation matters with an independent company competing in the aesthetics market (the Competitor). According to the terms of the settlement agreement, the Company has granted the Competitor an exclusive, world-wide license under certain of its patents to make and sell implant products containing Calcium Hydroxylapatite particles, and a nonexclusive, world-wide license under the same patents to make and sell certain other nonpolymeric implant products. The Competitor paid the Company $2,058,000 in November 2005 for the settlement plus past royalties. This amount is included in other income in the 2005 consolidated statements of operations.

Settlement Agreements

In March 2006, the Company entered into a separation agreement with a founder in connection with his retirement and resignation. Under the terms of the agreement, the Company agreed to pay a cash bonus of $70,000 for his performance during fiscal year 2005 and to retain him as a consultant for an initial term of up to 24 months beginning March 15, 2006, subject to an extension for an additional 12 months under certain circumstances. In connection with the separation agreement, the parties also entered into a voting agreement, pursuant to which the founder agreed to vote all shares of voting capital stock owned by him as directed by a majority of the board of directors on all matters presented for a vote of the stockholders. In May 2006, the Company terminated the consulting arrangement as permitted under the terms of the separation agreement and the Company paid a lump sum payment of $366,667, the amount to which the founder would have been entitled had he completed the initial term of the separation agreement.

In May 2006, the Company paid $500,000 to Stifel, Nicolaus & Company, Incorporated in connection with a settlement agreement related to a dispute arising out of an engagement agreement between the parties.

On November 2, 2006, the Company received a notice of demand for arbitration from a former employee in connection with the termination of his employment. On January 31, 2007, the Company entered into a Confidential Settlement and Release of Claims Agreement whereby the Company paid a cash settlement amount of $284,000 in February 2007. In addition to the cash settlement amount, the Company agreed to accelerate the vesting of certain stock options and warrants previously granted to the employee. The Company recorded a non-cash expense charge of $135,000 associated with the accelerated vesting of these options and warrants.

On November 16, 2006, the Company received a notice of demand for arbitration from a former employee in connection with the termination of his employment. On January 10, 2007, the Company entered into a Confidential Settlement and Release of Claims Agreement whereby the Company paid a cash settlement amount of $242,000. Of the $242,000, $39,000 was paid in 2006 and the remaining balance was paid in 2007. In addition to the cash settlement amount, the Company agreed to accelerate the vesting of certain stock options previously granted to the employee. The Company recorded a non-cash stock compensation expense charge of $116,000 associated with the accelerated vesting of these stock options.

On November 17, 2006, the Company entered into a separation agreement and mutual general release with Dr. Stefan M. Lemperle in connection with his resignation as a director and as an employee. Pursuant to the agreement, the Company paid $690,000 in cash severance payments. Of the $690,000, $428,000 was paid in 2006 and the balance of

$262,000 was paid in 2007. Dr. Stefan M. Lemperle was also eligible to receive an additional severance payment of $400,000, contingent upon the Company s completion of a qualifying transaction, as defined in the agreement, before March 31, 2007. The Company s IPO in December 2006 did not meet the definition of a qualifying transaction as defined in the agreement, so no additional payments were due to Dr. Lemperle. In connection with the agreement, the Company also amended the terms of the outstanding stock options held by Dr. Stefan M. Lemperle to provide for the full acceleration of all unvested shares under his stock options, and the Company has agreed to issue to Dr. Stefan M. Lemperle a warrant to purchase up to 117,647 shares of common

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Notes to Consolidated Financial Statements (Continued)

stock, subject to reduction in an amount determined in accordance with the terms of the agreement. The Company recorded a non-cash expense charge of $378,000 associated with the accelerated vesting of these options and warrants in the year ended December 31, 2006.

On November 6, 2006, the Company filed a demand for arbitration with the American Arbitration Association against Melvin Ehrlich, who served as the Company s President and Chief Operating Officer from January 2004 to April 2004. The Company was seeking declaratory relief regarding the number of shares of common stock Mr. Ehrlich was entitled to purchase under a warrant issued to him in connection with his employment agreement. The parties settled this action in March 2007. The Company paid Mr. Ehrlich $250,000 and issued Mr. Ehrlich 26,710 shares of common stock and a warrant to purchase 25,000 shares of common stock, at an exercise price of $8.07 per share. The settlement also contained a mutual release of claims and a mutual covenant not to sue. The Company accrued the expenses related to this settlement in the year ended December 31, 2006.

On August 13, 2007, Stefan Lemperle, the former Chief Executive Officer of the Company, filed a Demand for Arbitration with the American Arbitration Association, arising out of his November 17, 2006 Separation Agreement and General Release with the Company (the Separation Agreement). The Demand includes claims for breach of contract, breach of the covenant of good faith and fair dealing, and breach of fiduciary duty. In the Separation Agreement, the Company agreed to use commercially reasonable efforts to resolve an existing dispute with Mel Ehrlich, its former President and Chief Operating Officer, who claimed he had a right to acquire 470,588 shares of the Company s Common Stock. Based on the payment the Company made to Mr. Ehrlich to resolve this dispute, the Separation Agreement provided that Stefan Lemperle was entitled to receive a warrant to purchase up to 2,207 shares of Common Stock. The Company resolved its dispute with Mr. Ehrlich and agreed to issue Dr. Lemperle a warrant in accordance with the terms of the Separation Agreement. Dr. Lemperle claimed that the Company did not use commercially reasonable efforts to resolve its dispute with Mr. Erhlich. The matter settled on February 11, 2008 for a payment of $30,000 to Dr. Lemperle in consideration for a general release of all claims.

Sandor Litigation

In August 2005, Elizabeth Sandor, an individual residing in San Diego, California, filed a complaint against the Company, Drs. Gottfried Lemperle, Stefan Lemperle and Steven Cohen in the Superior Court of the State of California for the County of San Diego. The complaint, as amended, set forth various causes of action against the Company, including product liability, fraud, negligence and negligent misrepresentation, and alleged that Dr. Gottfried Lemperle, the Company s co-founder, former Chief Scientific Officer and a former director, treated Ms. Sandor with Artecoll and/or ArteFill in violation of medical licensure laws, that the product was defective and unsafe because it had not received FDA approval at the time it was administered to Ms. Sandor, and that Ms. Sandor suffered adverse reactions as a result of the injections.

In addition, the complaint alleged that Dr. Gottfried Lemperle and his son, Dr. Stefan Lemperle, the Company s co-founder, former Chief Executive Officer and a former director, falsely represented to her that the product had received an approvability letter from the FDA and was safe and without the potential for adverse reactions.

The complaint also alleged medical malpractice against Dr. Cohen, the lead investigator in the Company s U.S. clinical trial, for negligence in treating Ms. Sandor for the adverse side effects she experienced. Ms. Sandor sought damages in an unspecified amount for pain and suffering, medical and incidental expenses, loss of earnings and earning capacity,

punitive and exemplary damages, reasonable attorneys fees and costs of litigation. On June 1, 2006, the parties filed a stipulation to dismiss the case without prejudice and to toll the statute of limitations. The court dismissed the case on June 5, 2006 as stipulated by the parties, and Ms. Sandor was allowed to refile her case at any time within 18 months from that date.

On December 5, 2007, Ms. Sandor re-filed a complaint for personal injury, compensatory and punitive damages against the Company, Dr. Gottfried Lemperle, Dr. Stefan Lemperle and Dr. Steven Cohen. The complaint

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Notes to Consolidated Financial Statements (Continued)

contains many of the same allegations contained in the initial complaint filed in September 2005. The complaint sets forth various causes of action and alleges that Dr. Gottfried Lemperle administered injections of a product of the Company in violation of medical licensure laws, that the product was defective and unsafe in that it had not received FDA approval at the time it was administered to Ms. Sandor, and that Ms. Sandor suffered adverse reactions as a result of the injections. Ms. Sandor is seeking damages in an unspecified amount for special and actual damages, medical and incidental expenses, incidental and consequential damages, punitive and exemplary damages, reasonable attorney s fees and costs of litigation. The Company is preparing a demurrer to the complaint, and written discovery has commenced in this matter.

FDA Investigation

In March 2006, the counsel for Dr. Gottfried Lemperle, the Company s former Chief Scientific Officer and a former member of the Company s board of directors, in the Sandor litigation discussed above informed the Company that she had contacted an investigator in the FDA s Office of Criminal Investigations. She further stated that the FDA investigator informed her that the FDA has an open investigation regarding the Company, Dr. Gottfried Lemperle and his son, Dr. Stefan Lemperle, the Company s former Chief Executive Officer and a former director, that the investigation had been ongoing for many months, that the investigation would not be completed within six months, and that when the investigation is completed, it could be referred to the U.S. Attorney s office for criminal prosecution. In November 2006, the Company contacted the FDA s Office of Criminal Investigations. That office confirmed the ongoing investigation involving the Company, but declined to provide any details of the investigation, including the timing, status, scope or targets of this investigation. The Company contacted the FDA s Office of Criminal Investigations in February 2008. The Office of Criminal Investigations confirmed that the investigation is ongoing and has been referred to the U.S. Attorney s office, but did not provide any additional information regarding this investigation or whether the U.S. Attorney s office intends to commence an action.

7. Convertible Notes Payable

In May 2005, the Company received $6,970,000 in proceeds by issuing unsecured convertible promissory notes (2005 Bridge Loan) that were to accrue simple interest at 10% per annum until the maturity date of November 3, 2005. At the sole discretion of the Company, the maturity date was subject to a one-time extension to February 3, 2006. The Company exercised its right of the one-time extension, the applicable interest rate increased to 12% retroactively to the date of issuance of the 2005 Bridge Loan. At the closing of the next equity financing, the holders of the 2005 Bridge Loan elected not to convert all or a portion of the outstanding principal and accrued but unpaid interest into the new equity shares at the per share price of those shares but rather to be repaid the balance due under the 2005 Bridge Loan.

Simultaneously upon issuance of the 2005 Bridge Loan, the Company issued warrants to purchase Series D convertible preferred stock equal to 30% of the principal amounts of the 2005 Bridge Loan divided by the warrant exercise price of $2.00 per share, or warrants to purchase 1,045,500 shares of Series D convertible preferred stock. The warrants expire in May 2010.

In accordance with EITF 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments, the Company initially recorded its convertible debt net of a discount for the (i) the estimated fair value of the warrants issued in the amount of $1,003,500 and (ii) the intrinsic value of the related beneficial conversion feature in the same amount for a

total of $2,007,000. The estimated fair value of the warrants was determined in accordance with the Black-Scholes valuation model. The discount associated with the warrants and beneficial conversion feature is being amortized to interest expense over the term of the outstanding convertible notes payable.

Interest expense related to the warrants and beneficial conversion features was $0, $235,000 and $1,772,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

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Notes to Consolidated Financial Statements (Continued)

On September 30, 2005, outstanding principal amount of $970,000 and accrued interest of $39,000 under the convertible notes issued in the 2005 Bridge Loan converted into 403,412 shares of Series E convertible preferred stock at a rate of $2.50 per share.

On December 30, 2005, the Company entered into an amendment of the 2005 Bridge Loan with an investor who held convertible promissory notes representing an outstanding principal amount of $5,500,000, whereby the Company paid, in January 2006, a total of $3,246,000, consisting of $3,000,000 of outstanding principal and $246,000 of accrued interest, upon the second closing of the Series E Financing. In February 2006, upon the third closing of the Series E Financing, the Company paid an additional $2,738,000, consisting of $2,500,000 of outstanding principal and $238,000 of accrued interest, the final amount due under the 2005 Bridge Loan.

Per the note amendment, the investor waived both its conversion and redemption options under the original note and extended the due date of the remaining outstanding principal of $2,500,000 from February 3, 2006 to February 15, 2006. As additional consideration, the Company granted the investor a stock grant of 250,000 shares of Series E convertible preferred stock in December 2005. In addition, three Company directors personally guaranteed the remaining outstanding principal under the amended note agreement. In exchange for the personal guarantees, the Company issued each of these three directors 23,529 shares of common stock. At December 31, 2005, the common stock had not yet been issued and is included as common stock issuable in the 2005 consolidated balance sheet and the consolidated statement of stockholders equity.

8. Stockholders Equity

On December 26, 2006, the Company closed an initial public offering of its common stock in which it sold 5,290,000 shares of common stock at $6.00 per share for gross proceeds of $31.7 million. After underwriting discounts, commissions and offering expenses, the Company received net proceeds of $25.3 million. Upon the closing of the offering, all outstanding shares of convertible preferred stock converted into 9,367,512 shares of common stock.

Convertible Preferred Stock

In May 2005, the Company issued 5,789,801 shares of Series D convertible preferred stock at $1.25 per share and 4,230,055 shares of Series D convertible preferred stock at $2.00 per share for a total of $15,197,000 and interest accrued to the holders of a 2004 convertible notes payable (2004 Notes) of $500,000. The total investment was comprised of $8,460,000 in subscriptions for a total of 4,230,055 shares of Series D convertible preferred stock and $7,237,000 of convertible promissory notes payable (2004 Notes), including accrued interest of $500,000, which converted into a total of 5,789,801 shares of Series D convertible preferred stock.

The Company issued warrants to purchase an aggregate of 198,310 shares of common stock, at an exercise price of $8.50 per share, to certain purchasers of Series D convertible preferred stock. The warrants may be exercised any time for a period of five years. The purchasers that were issued shares of Series D convertible preferred stock in connection with the conversion of promissory notes previously issued by the Company did not receive such warrants.

In August 2005, the Company obtained stockholder approval to open an offering to sell approximately ten million shares of Series E convertible preferred stock at $2.50 per share for gross proceeds of $25 million (the Series E Financing).

The Series E Financing closed in five rounds from December 2005 through March 2006, resulting in gross proceeds of $50.7 million, including the conversion of $1,009,000 of the outstanding 2005 Bridge Loan and related accrued interest.

On December 22, 2005, the first round closed with total proceeds of $7.7 million, including the conversion of $970,000 of the outstanding 2005 Bridge Loan and $39,000 of accrued interest, resulting in the issuance of

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Notes to Consolidated Financial Statements (Continued)

3,213,615 shares of Series E convertible preferred stock. Cash proceeds were received of $6.7 million for the purchase of 2,686,203 shares. An additional 403,412 shares were issued for the conversion of $1,009,000 of the outstanding 2005 Bridge Loan including accrued interest of $39,000.

In December 2005, the Company engaged a placement agent to secure the sale of up to $10 million in additional Series E convertible preferred stock. A purchaser of less than $5.0 million of Series E convertible preferred stock would receive a warrant to purchase one share of Series E convertible preferred stock for each five shares of Series E convertible preferred stock purchased, or 20% of the amount purchased. A purchaser of $5.0 million or more of Series E convertible preferred stock would receive a warrant to purchase one share of Series E convertible preferred stock for each 14.0 shares of Series E convertible preferred stock purchased, or 30% of the amount purchased. The warrants have an exercise price of $10.63 per share. The warrants may be exercised any time for a period of five years.

On January 6, 2006, the Company closed the second round of its Series E Financing. Upon closing, total gross proceeds of $6,750,000 were received resulting in the issuance of 2,700,000 shares of Series E convertible preferred stock and warrants for the future purchase of 702,000 shares of Series E convertible preferred stock at $2.50 per share. The warrants expire January 6, 2011. In addition, the Company issued a warrant for the future purchase of 16,875 shares of common stock at $5.31 per share. This warrant expires January 6, 2011.

On January 13, 2006, the Company closed the third round of Series E Financing. Upon closing, total gross proceeds of $3,235,000 were received resulting in the issuance of 1,294,000 shares of Series E convertible preferred stock and warrants for the future purchase of 536,440 shares of Series E convertible preferred stock at $2.50 per share. The warrants expire January 13, 2011. In addition, the Company issued a warrant for the future purchase of 8,088 shares of common stock at $5.31 per share. This warrant expires January 13, 2011.

On February 14, 2006, the Company closed its fourth round of Series E Financing. Upon closing, total gross proceeds of $13,711,000 were received resulting in the issuance of 5,484,200 shares of Series E convertible preferred stock and warrants for the future purchase of 948,420 shares of convertible Series E convertible preferred stock at $2.50 per share. The warrants expire February 14, 2011. In addition, the Company issued a warrant for the future purchase of 5,727 shares of common stock at $5.31 per share. This warrant expires February 14, 2011.

On March 28, 2006, the Company closed the fifth and final round of Series E Financing. Upon closing, total gross proceeds of $19,281,000 were received resulting in the issuance of 7,712,406 shares of Series E convertible preferred stock and warrants for the future purchase of 1,451,582 shares of Series E convertible preferred stock at $2.50 per share. The warrants expire March 28, 2011.

In October 2005, the Company entered into a termination agreement with certain financial advisors. In exchange for the termination agreement the Company issued 124,000 shares of Series E convertible preferred stock at $2.50 per share. The Company expensed $310,000 as stock-based compensation during the year ended December 31, 2005 related to this termination agreement.

At December 31, 2007, 2006 and 2005, the Company was authorized to issue 10,000,000, 10,000,000 and 35,000,000 shares of preferred stock, respectively.

Conversion

In connection with the Company s initial public offering, the Company effected a 1-for-4.25 reverse stock split of its common stock on December 19, 2006. In addition to the reverse stock split, all outstanding shares of the Company s preferred stock were converted to common stock immediately prior to the closing of the Company s initial public offering on December 26, 2006. Each outstanding share of Series A, Series D and Series E preferred stock was converted into one share of common stock, and as a result of anti-dilution provisions, each one share of Series B preferred stock was converted into 1.35 shares of common stock and each one share of Series C-1 preferred stock was converted into 1.375 shares of common stock.

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On December 26, 2006, after giving effect to the 1-for-4.25 reverse stock split, and the anti-dilution provisions associated with the Series B and C-1 convertible preferred stock, all of the outstanding shares of convertible preferred stock were automatically converted into 9,367,512 shares of common stock.

Stock Option Plans

In 2006, the Company adopted the 2006 Equity Incentive Plan (the 2006 Plan) for eligible employees, officers, directors, advisors, and consultants that provides for the grant of incentive and nonstatutory stock options and other awards. The Company has 5,882,353 shares of common stock options authorized under the 2006 Plan. Terms of the stock option agreements, including vesting requirements, are determined by the Board of Directors, subject to the provisions of the 2006 Plan. Options granted by the Company generally vest over two to four years and vested options are exercisable from the date of grant for a period of ten years. The exercise price of the incentive stock options must equal at least the fair market value of the stock on the date of grant.

In 2001, the Company adopted the 2001 Stock Option Plan (the 2001 Plan) for eligible employees, officers, directors, advisors, and consultants that provides for the grant of incentive and nonstatutory stock options. The 2001 Plan superseded the Company s 2000 Stock Option Plan (the 2000 Plan). Following the adoption of the 2001 Plan, no further option grants were made under the 2000 Plan. Terms of the stock option agreements, including vesting requirements, are determined by the Board of Directors, subject to the applicable provisions of the 2000 Plan or 2001 Plan. Options granted by the Company generally vest over four years and vested options are exercisable from the date of grant for a period of ten years. The exercise price of the incentive stock options must equal at least the fair market value of the stock on the date of grant. All the shares of stock that remained available for issuance and not subject to outstanding options under the 2000 Plan and 2001 Plan became part of the available pool of shares under the 2006 Plan. No further option grants will be made under the 2000 Plan or 2001 Plan.

The exercise price of nonstatutory stock options under the 2000 Plan and the 2001 Plan must equal at least 85% of the fair market value of the stock on the date of grant. The exercise price of any incentive stock option granted to a 10% stockholder may be no less than 110% of the fair value of the Company s common stock on the date of grant. As of December 31, 2007, there were 25,880 and 3,126,198 options outstanding under the 2000 Plan and 2006 Plan, respectively, and 29,880 options granted outside the 2000 Plan and 2006 Plan.

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Notes to Consolidated Financial Statements (Continued)

The following table summarizes stock option activity under the Company s stock option plans (shares in thousands):

	Options	Weighted-Average Exercise Price
Outstanding, December 31, 2004	560	$ 3.57
Granted	611	5.31
Exercised	(6)	4.25
Canceled	(16)	5.31
Outstanding, December 31, 2005	1,149	4.46
Granted	1,320	8.00
Exercised	(99)	3.49
Canceled	(236)	4.91
Outstanding, December 31, 2006	2,134	6.65
Granted	1,392	7.58
Exercised	(47)	2.47
Canceled	(297)	7.05
Outstanding, December 31, 2007	3,182	$ 7.08
Vested or expected to vest at December 31, 2007	2,577	$ 6.99

The weighted average remaining contractual term of outstanding options at December 31, 2007 is 8.27 years. The aggregate intrinsic value of such options is $73,515. The weighted average remaining contractual term of exercisable options at December 31, 2007 is 7.21 years. The aggregate intrinsic value of such options is $65,399. Intrinsic value represents the difference between the option price at grant date and the market price of the Company s common stock, which was $2.27 at December 31, 2007.

The total intrinsic value of options exercised during the year ended December 31, 2007 is $194,866.

The following table summarizes information about options outstanding at December 31, 2007 under the 2000, 2001 and 2006 Plans:

	Options Outstanding			Options Exercisable	
Grant Exercise Price	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average	Number Exercisable	Weighted-Average

			Exercise Price		Exercise Price
$ 0.43 - $ 4.25	387,222	6.2 years	$ 3.19	210,464	$ 3.27
$ 5.31 - $ 5.31	715,452	7.7 years	5.31	415,957	5.31
$ 6.31 - $ 7.86	1,167,008	8.8 years	7.47	304,456	7.71
$ 7.90 - $ 9.96	635,700	9.1 years	9.20	126,434	8.62
$10.63 - $10.63	276,576	8.4 years	10.63	109,204	10.63
	3,181,958	8.3 years	$ 7.08	1,166,515	$ 6.42

On December 26, 2006, upon the closing of the Company s initial public offering, stock options to purchase 78,855 shares of common stock granted to Outside Directors became fully vested. The Company recorded $547,000 related to the acceleration of these stock options.

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Notes to Consolidated Financial Statements (Continued)

Warrants

As of December 31, 2006, after giving effect to a 1- for- 4.25 reverse stock split of the Company s outstanding common stock and the conversion of all outstanding shares of the Company s preferred stock into common stock (taking into account the anti-dilution provisions of the Series B convertible preferred stock and the Series C-1 convertible preferred stock) in connection with the initial public offering of the Company s common stock, warrants to purchase 2,530,336 shares of the Company s common stock, at a weighted average exercise price of $7.03 were outstanding.

The following table summarizes warrant activity for the year ended December 31, 2007:

	Warrants	Weighted Avg. Exercise Price
Outstanding, December 31, 2006	2,530,336	$ 7.00
Granted	25,000	8.07
Exercised	(78,816)	5.31
Cancelled	(5,882)	8.50
Outstanding, December 31, 2007	2,470,638	$ 7.06

All outstanding warrants are exercisable as of December 31, 2007.

In February 2008, the Company issued 1,675,000 of warrants in relation to the financing arrangement with CHRP (Note 12). 1,300,000 warrants have an exercise price of $5.00 while 375,000 warrants have an exercise price of $3.13.

Common Shares Reserved for Issuance

The following table summarizes common shares reserved for future issuance on exercise or conversion of the following:

	December 31, 2007
Warrants for common and preferred stock	2,470,638
Common stock options outstanding previous to 2001 Plan	55,760
Common stock options outstanding under 2001 and 2006 Plans	3,126,198
Common stock options available for future grant	2,381,582
Total common shares reserved for issuance	8,034,178

9. Income Taxes

In June 2006, the FASB issued Interpretation No. 48, or FIN 48, Accounting for Uncertainty in Income Taxes an Interpretation of FAS 109. FIN 48 provides clarification for the financial statement measurement and recognition of tax positions that are taken or expected to be taken in a tax return. The Company adopted FIN 48 effective January 1, 2007.

The adoption of FIN 48 did not impact the Company s financial condition, results of operations or cash flows for the year ended December 31, 2007. At December 31, 2007, the Company had net deferred tax assets of $3.7 million. These deferred tax assets are primarily composed of differences in inventory basis, deferred rent and stock compensation expense. Due to uncertainties surrounding the Company s ability to generate future taxable income to realize these assets, a valuation has been established to offset the net deferred tax asset. Additionally, the future utilization of the company s net operating loss and research and development credit carryforwards to offset future taxable income may be subject to an annual limitation as a result of ownership changes that may have

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Artes Medical, Inc.

Notes to Consolidated Financial Statements (Continued)

occurred previously or that could occur in the future. The Company has not yet determined whether such an ownership change has occurred; however the Company is in the process of completing a Section 382 analysis regarding the limitation of the net operating loss and research and development credits. Until this analysis has been completed the Company has removed the deferred tax assets associated with these carryforwards from its deferred tax asset schedule and has recorded a corresponding decrease to their valuation allowance. When the Section 382 analysis is completed, the Company plans to update its unrecognized tax benefits under FIN 48. The Company expects the Section 382 analysis to be completed within the next twelve months.

Significant components of the Company s net deferred tax assets at December 31, 2007 and 2006 are shown below (in thousands). A valuation allowance of $3.5 million and $28.4 million has been established to offset the net deferred tax assets as of December 31, 2007 and 2006, respectively, as realization of such assets is uncertain.

At December 31, 2007, the Company had federal and California tax net operating loss carryforwards of approximately $83 million and $82 million, respectively. The federal and state tax loss carryforwards begin to expire in 2019 and 2009, respectively, unless previously utilized.

	December 31,	
	2007	2006
	(In thousands)	
Deferred tax assets:		
Net operating loss carryforwards	$	$ 24,885
Reserves and other	3,677	3,840
Total deferred tax assets	3,677	28,725
Valuation allowance for deferred tax assets	(3,538)	(28,447)
	139	278
Deferred tax liabilities:		
Foreign intangible	(915)	(1,368)
Other	(139)	(278)
Total deferred tax liabilities	(1,054)	(1,646)
Net deferred tax liabilities	$ (915)	$ (1,368)

The components of the benefit (expense) for income taxes are as follows (in thousands):

	Years Ended December 31,		
	2007	2006	2005

Current:			
Federal	$	$	$
State			
Foreign	90		(37)
	90		(37)
Deferred:			
Federal			
State			
Foreign	452	476	495
	452	476	495
	$ 542	$ 476	$ 458

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Notes to Consolidated Financial Statements (Continued)

Reconciliation of the statutory federal income tax benefit to the Company s effective tax benefit (in thousands):

	December 31,		
	2007	**2006**	**2005**
Tax benefit at federal statutory rate	$ 9,325	$ 9,114	$ 7,718
State, net of federal benefit	1,576	1,541	1,324
Tax credits	198	308	
Foreign tax	437	476	458
Change in valuation allowance due to 382 study pending	(33,448)		
Change in valuation allowance excluding change applicable to purchased intangibles	24,909	(9,101)	(8,202)
Change in valuation allowance applicable to purchased intangibles			5
Other foreign loss	(371)	(408)	(457)
Other permanent differences	(2,084)	(1,454)	(388)
Benefit for income taxes	$ 542	$ 476	$ 458

10. Employee Benefit Plan

Effective January 1, 2000, the Company adopted a defined contribution 401(k) profit sharing plan (the Plan) covering substantially all employees that meet certain age requirements. Employees may contribute up to 100% of their compensation per year (subject to a maximum limit by federal law). The Plan does allow for employer matching. To date, no employer match has been made.

11. Related-Party Transactions

On December 30, 2005, the Company entered into an amendment of the 2005 Bridge Loan with an investor. Per the note amendment, the investor waived both its conversion and redemption options under the original note and extended the due date of the remaining outstanding principal. Three Company directors personally guaranteed the remaining outstanding principal under the amended note agreement. In exchange for the personal guarantees, the three Company directors were each granted 23,529 shares of common stock. At December 31, 2005, the common stock had not yet been issued and is included as common stock issuable in the 2005 consolidated balance sheet and the consolidated statement of stockholders equity. On January 3, 2006, the common shares were issued.

12. Subsequent Events

In January 2008, the Company entered into a entered into a financing arrangement (the Financing) with Cowen Healthcare Royalty Partners, L.P. (CHRP) to raise $21.5 million, and the potential for an additional $1 million in 2009 contingent upon the Company s satisfaction of a net product sales milestone. The Company intends to use the proceeds to expand both its dedicated U.S. sales force and consumer outreach programs. In February 2008, the Company repaid the total amount due of $8.6 million to Comerica Bank under the term loan and the line of credit and terminated the

line of credit. After the Comerica Bank payment and the payment of certain transaction expenses, the Company received net proceeds of $12.6 million.

Under the Revenue Interest Financing and Warrant Purchase Agreement (the Revenue Agreement), CHRP acquired the right to receive a revenue interest on the Company s U.S. net product sales from October 2007 through December 2017 (the Term). The Company is required to pay a revenue interest on U.S. net product sales of ArteFill®, any improvements to ArteFill®, any internally developed products and any products in-licensed or purchased by the Company, provided that such improvements, internally developed, in-licensed or purchased products are primarily used for or have an FDA-approved indication in the field of cosmetic, aesthetic or

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Notes to Consolidated Financial Statements (Continued)

dermatologic procedures. The scope of the products subject to CHRP s revenue interest narrows following the date the cumulative payments the Company makes to CHRP first exceed a specified multiple of the consideration paid by CHRP for the revenue interest. In addition, the Company is required to make two lump sum payments of $7.5 million to CHRP, the first in January 2012 and the second in January 2013.

Under the Revenue Agreement, the Company issued CHRP a warrant to purchase 375,000 shares of Common Stock, at an exercise price equal to $3.13 per share. This warrant has a 5 year term, and allows for cashless exercise.

As part of the Financing, the Company also entered into a Note and Warrant Purchase Agreement (the Note and Warrant Agreement) with CHRP pursuant to which the Company agreed to issue and sell to CHRP, at the closing of the Financing, a 10% senior secured note in the principal amount of $6,500,000 (the Note). The Note has a term of five (5) years and bears interest at 10% per annum, payable monthly in arrears. The Company will have the option to prepay all or a portion of the Note at a premium. In the event of an event of default, with event of default defined as (i) a Put Event, (ii) a failure to pay the Note when due, (iii) the Company s material breach of its covenants and agreements in the Note and Warrant Agreement, (iv) the Company s failure to perform an existing agreement with a third party that accelerates the majority of any Debt in excess of $500,000 or (v) subject to a cure period, material breach of the covenants, representations or warranties in the Financing documents, the outstanding principal and interest in the Note, plus the prepayment premium, shall become immediately due and payable.

Under the Note and Warrant Agreement, the Company issued CHRP a warrant to purchase 1,300,000 shares of Common Stock, at an exercise price equal to $5.00 per share. This warrant has a 5 year term, and allows for cashless exercise.

13. Quarterly Information (Unaudited)

The following quarterly information includes all adjustments which management considers necessary for a fair statement of such information. For interim quarterly financial statements, the provision for income taxes is estimated using the best available information for projected results for the entire year.

	2007			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In thousands, except per share data)			
Product sales	$ 1,442	$ 2,055	$ 1,220	$ 2,367
License revenues		732	5,500	
Total revenues	1,442	2,787	6,720	2,367
Cost of product sales	1,720	2,159	3,002	3,778
Gross profit (loss)	(278)	628	3,718	(1,411)

Research and development	1,032	1,136	1,541	2,314
Selling, general and administrative	5,570	6,327	5,868	6,566
Loss from operations	(6,880)	(6,835)	(3,691)	(10,291)
Net loss	$ (6,609)	$ (6,656)	$ (3,682)	$ (9,938)
Net loss per share Basic and diluted	$ (0.40)	$ (0.40)	$ (0.22)	$ (0.60)
Shares used in calculating net loss per share Basic and diluted	16,380,633	16,459,103	16,493,767	16,514,163

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Notes to Consolidated Financial Statements (Continued)

	2006			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In thousands, except per share data)			
License revenues	$	$ 390	$	$
Total revenues		390		
Research and development	2,949	1,530	1,219	2,386
Selling, general and administrative	3,194	4,868	3,401	5,836
Loss from operations	(6,143)	(6,008)	(4,620)	(8,222)
Net loss	$ (7,981)	$ (6,186)	$ (4,402)	$ (7,754)
Net loss per share Basic and diluted	$ (6.14)	$ (4.59)	$ (3.17)	$ (2.32)
Shares used in calculating net loss per share Basic and diluted	1,300,634	1,347,993	1,387,036	3,348,125

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Schedule II

Artes Medical, Inc.

Valuation and Qualifying Accounts
For the years ended December 31, 2007, 2006 and 2005

	Balance at Beginning of Year	Charged to Costs and Expenses	Deductions	Balance at End of Year
Allowance for doubtful accounts receivable				
2005	$	$	$	$
2006				
2007		72,474	52,474	20,000
Reserve for excess, obsolete and short-dated inventories				
2005	$	$	$	$ 236,750
2006	236,750	917,137	399,513	754,374
2007	754,374	3,764,188	2,280,861	2,237,701

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