BIOLASE TECHNOLOGY INC
Form 10-Q
November 03, 2010

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

FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2010
OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________
Commission File Number 000-19627

BIOLASE TECHNOLOGY, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**87-0442441**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

4 Cromwell
Irvine, California 92618
(Address of principal executive offices, including zip code)
(949) 361-1200
(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller Reporting Company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.): Yes o No þ

Number of shares outstanding of the registrant s common stock, $0.001 par value, as of October 29, 2010: 24,584,565

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

BIOLASE TECHNOLOGY, INC.
CONSOLIDATED BALANCE SHEETS (Unaudited)
(in thousands, except per share data)

	September 30, 2010		December 31, 2009	
ASSETS				
Current assets:				
Cash and cash equivalents	$	2,226	$	2,975
Accounts receivable, less allowance of $345 and $421 in 2010 and 2009, respectively		2,861		4,229
Inventory		8,432		7,861
Prepaid expenses and other current assets		887		1,347
Assets held for sale		592		
Total current assets		14,998		16,412
Property, plant and equipment, net		996		2,180
Intangible assets, net		374		472
Goodwill		2,926		2,926
Deferred tax asset		28		17
Other assets		171		170
Total assets	$	19,493	$	22,177
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)				
Current liabilities:				
Term loan payable, current portion	$	1,138	$	
Accounts payable		4,223		4,887
Accrued liabilities		4,333		5,152
Customer deposits		8,418		
Deferred revenue, current portion		1,380		1,123
Total current liabilities		19,492		11,162
Term loan payable, long-term		1,765		
Deferred tax liabilities		527		473
Warranty accrual, long-term		636		448
Deferred revenue, long-term		441		1,975
Other liabilities, long-term		179		190
Total liabilities		23,040		14,248
Stockholders equity (deficit):				
Preferred stock, par value $0.001, 1,000 shares authorized, no shares issued and outstanding				
		27		27

Common stock, par value $0.001, 50,000 shares authorized; 26,507 and 26,340 shares issued and 24,543 and 24,376 shares outstanding in 2010 and 2009, respectively				
Additional paid-in capital		118,014		117,228
Accumulated other comprehensive loss		(289)		(222)
Accumulated deficit		(104,900)		(92,705)
		12,852		24,328
Treasury stock (cost of 1,964 shares repurchased)		(16,399)		(16,399)
Total stockholders equity (deficit)		(3,547)		7,929
Total liabilities and stockholders equity (deficit)	$	19,493	$	22,177

See accompanying notes to consolidated financial statements.

BIOLASE TECHNOLOGY, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Products and services revenue	$ 6,002	$ 11,796	$ 15,085	$ 31,802
License fees and royalty revenue	218	289	1,422	1,194
Net revenue	6,220	12,085	16,507	32,996
Cost of revenue	4,429	6,252	12,515	17,297
Gross profit	1,791	5,833	3,992	15,699
Operating expenses:				
Sales and marketing	2,110	2,231	7,825	8,046
General and administrative	1,330	1,699	5,031	6,003
Engineering and development	775	999	2,990	3,201
Total operating expenses	4,215	4,929	15,846	17,250
(Loss) income from operations	(2,424)	904	(11,854)	(1,551)
Gain (loss) on foreign currency transactions	(118)	(40)	(75)	166
Interest income	1	1	2	4
Interest expense	(157)	(7)	(216)	(49)
Non-operating (loss) income, net	(274)	(46)	(289)	121
(Loss) income before income tax provision (benefit)	(2,698)	858	(12,143)	(1,430)
Income tax provision (benefit)	28	(1)	52	57
Net (loss) income	$ (2,726)	$ 859	$ (12,195)	$ (1,487)
Net (loss) income per share:				
Basic	$ (0.11)	$ 0.04	$ (0.50)	$ (0.06)
Diluted	$ (0.11)	$ 0.04	$ (0.50)	$ (0.06)
Shares used in the calculation of net (loss) income per share:				
Basic	24,428	24,281	24,403	24,257
Diluted	24,428	24,540	24,403	24,257

See accompanying notes to consolidated financial statements.

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BIOLASE TECHNOLOGY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(in thousands)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Cash Flows From Operating Activities:		
Net loss	$ (12,195)	$ (1,487)
Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	830	1,126
Loss on disposal of assets, net	3	13
Impairment of property, plant and equipment	35	
Recovery for bad debts	(47)	(134)
Provision for inventory excess and obsolescence		946
Amortization of discounts on term loan payable	17	
Amortization of debt issuance costs	39	
Stock-based compensation	499	1,103
Other non-cash compensation	24	
Deferred income taxes	43	46
Changes in operating assets and liabilities:		
Accounts receivable	1,415	626
Inventory	(571)	2,376
Prepaid expenses and other assets	407	62
Customer deposits	8,418	
Accounts payable and accrued liabilities	(1,206)	(5,103)
Deferred revenue	(1,278)	(1,357)
Net cash and cash equivalents used in operating activities	(3,567)	(1,783)
Cash Flows From Investing Activities:		
Proceeds from sale of property, plant and equipment		5
Additions to property, plant and equipment	(220)	(333)
Net cash and cash equivalents used in investing activities	(220)	(328)
Cash Flows From Financing Activities:		
Borrowings under line of credit		4,293
Payments under line of credit		(9,697)
Proceeds from term loan payable	3,000	
Payment of debt issuance costs	(85)	
Proceeds from exercise of stock options and warrants	148	139
Net cash and cash equivalents provided by (used in) financing activities	3,063	(5,265)
Effect of exchange rate changes	(25)	20
Decrease in cash and cash equivalents	(749)	(7,356)

Cash and cash equivalents, beginning of year		2,975		11,235
Cash and cash equivalents, end of period	$	2,226	$	3,879
Supplemental cash flow disclosure:				
Cash paid (refunded) during the period for:				
Interest	$	113	$	49
Income taxes	$	(95)	$	14

See accompanying notes to consolidated financial statements.

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BIOLASE TECHNOLOGY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

NOTE 1 BASIS OF PRESENTATION

The Company

BIOLASE Technology, Inc. or the Company or Biolase, incorporated in Delaware in 1987, is a medical technology company operating in one business segment that designs, manufactures and markets advanced dental, cosmetic and surgical lasers and related products.

Basis of Presentation

The unaudited consolidated financial statements include the accounts of BIOLASE Technology, Inc. and its consolidated subsidiaries and have been prepared on a basis consistent with the December 31, 2009 audited consolidated financial statements and include all material adjustments, consisting of normal recurring adjustments and the elimination of all material intercompany transactions and balances, necessary to fairly present the information set forth therein. These unaudited, interim, consolidated financial statements do not include all the footnotes, presentations and disclosures normally required by accounting principles generally accepted in the United States of America, or GAAP, for complete consolidated financial statements. Certain amounts have been reclassified to conform to current period presentation.

Use of Estimates

The preparation of these consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect amounts reported in the consolidated financial statements and the accompanying notes. Significant estimates in these consolidated financial statements include allowances on accounts receivable, inventory and deferred taxes, as well as estimates for accrued warranty expenses, the realizability of goodwill and indefinite-lived intangible assets, effects of stock-based compensation and the provision or benefit for income taxes. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may differ materially from those estimates.

Fair Value of Financial Instruments

Our financial instruments, consisting of cash, accounts receivable, accounts payable and other accrued expenses, approximate fair value because of the short maturity of these items. Financial instruments consisting of long and short term debt approximate fair value since the interest rate approximates the market rate for debt securities with similar terms and risk characteristics.

Revenue Recognition

Effective August 30, 2010, our products are sold domestically directly to customers through our direct sales force and through non-exclusive distributors. Sales are recorded upon shipment from our facility and payment of our invoices is generally due within 30 days or less. Internationally, we sell products through independent distributors including Henry Schein, Inc., or HSIC, in certain countries. We recognize revenue based on four basic criteria that must be met before revenue can be recognized: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred and title and the risks and rewards of ownership have been transferred to our customer, or services have been rendered; (iii) the price is fixed or determinable; and (iv) collectability is reasonably assured.

Sales of our laser systems include separate deliverables consisting of the product, disposables used with the laser systems, certain support services, installation and training. For these sales, we apply the residual value method, which requires us to allocate to the delivered elements the total arrangement consideration less the fair value of the undelivered elements. Revenue attributable to the undelivered elements, primarily training, is included in deferred revenue when the product is shipped and is recognized when the related service is performed or upon expiration of time offered under the agreement.

The key judgments related to our revenue recognition relates to the collectability of payment from the customer and the satisfaction of all elements of the arrangement having been delivered and that no additional customer credits and discounts are needed. We evaluate the customer s credit worthiness prior to the shipment of the product. Based on our assessment of the credit information available to us, we may determine the credit risk is higher than normally acceptable, and we will either decline the purchase or defer the revenue until payment is reasonably assured. Future obligations required at the time of sale may cause us to defer the revenue until the obligation is satisfied.

Although all sales are final, we accept returns of products in certain, limited circumstances and record a provision for sales returns based on historical experience concurrent with the recognition of revenue. The sales returns allowance is recorded as a reduction of accounts receivable and revenue.

We recognize revenue for royalties under licensing agreements for our patented technology when the product using our technology is sold. We estimate and recognize the amount earned based on historical performance and current knowledge about the business operations of our licensees. Our estimates have been consistent with amounts historically reported by the licensees. Licensing revenue related to exclusive licensing arrangements is recognized concurrent with the related exclusivity period.

We may offer sales incentives and promotions on our products. We recognize the cost of sales incentives at the date at which the related revenue is recognized as a reduction in revenue or as a selling expense, as applicable, or later, in the case of incentives offered after the initial sale has occurred.

Liquidity and Management s Plans

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and settlement of obligations in the normal course of business. We have incurred significant net losses and net revenue has declined during the past three years. As of September 30, 2010, we had $2.2 million in cash and cash equivalents to finance operations and to satisfy our obligations. On September 23, 2010, we entered into a new distribution agreement (See Note 7) with HSIC, effective August 30, 2010, that changed our distributor relationship with HSIC from an exclusive to a non-exclusive distributor of our products. Under the Agreement, we granted HSIC certain non-exclusive distribution rights in North America, and in certain other international markets, with respect to our dental laser systems, accessories, and related support and services in certain circumstances. In addition, we granted HSIC exclusivity in selected international markets subject to review of certain performance criteria. In connection with this Agreement, HSIC made prepayments of $3 million and placed an irrevocable $9 million open purchase order for our products, $6 million of which will be for the purchase of the iLase, with an option for an additional $3 million of iLase or for other laser systems. In respect of the February 16, 2010 and March 9, 2010 letter agreements with HSIC, and the September 23, 2010 distribution agreement, we have received advance payments totaling $14.8 million, of which $8.4 million remained a customer deposit at September 30, 2010 and will be applied against the open purchase orders. Beginning on September 1, 2010, we have sold our products through our direct sales force.

On May 27, 2010 we entered into a Loan and Security Agreement in respect of a $5 million term loan, $3 million of which was funded on such date. On September 23, 2010 we entered into Waiver and Amendment No. 1 to the Loan and Security Agreement which, among other things, waived our non-compliance at June 30, 2010 and September 30, 2010 with a financial covenant contained in the Loan and Security Agreement (See Note 8). In addition to the loan funding we received, we implemented cost cutting measures in the second and third quarters of 2010 which included a reduction in headcount of approximately 25 full time employees.

Our ability to meet our obligations in the ordinary course of business is dependent upon our ability to sell our products directly to the end-user and through distributors, raise additional financing through public or private equity or debt financing, to establish profitable operations through increased sales and decreased expenses, or to secure other sources of financing to fund operations. Management intends to seek to increase sales through the efforts of our direct sales force and through our distributor relationships domestically and around the world. However, there can be no assurance we will be able to increase sales, reduce expenses or line up new financing sources.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

Newly Adopted Accounting Standards

In May 2009, the FASB established general standards for accounting and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The pronouncement required the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, whether that date represents the date the financial statements were issued or were available to be issued. On February 24, 2010, the FASB amended this standard whereby SEC filers, like the Company, are required by GAAP to evaluate subsequent events through the date its financial statements are issued, but are no longer required to disclose in the financial statements that the Company has done so or disclose the date through which subsequent events have

been evaluated.

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In August 2009, the FASB provided clarification when measuring liabilities at fair value of a circumstance in which a quoted price in an active market for an identical liability is not available. A reporting entity is required to measure fair value using one or more of the following methods: 1) a valuation technique that uses a) the quoted price of the identical liability when traded as an asset or b) quoted prices for similar liabilities (or similar liabilities when traded as assets) and/or 2) a valuation technique that is consistent with the preexisting fair value guidance. It also clarifies that when estimating the fair value of a liability, a reporting entity is not required to adjust to include inputs relating to the existence of transfer restrictions on that liability. The adoption did not have a material impact on our consolidated financial statements.

Accounting Standards Not Yet Adopted

In October 2009, the Financial Accounting Standard Board issued an update to existing guidance on accounting for arrangements with multiple deliverables. This update will allow companies to allocate consideration received for qualified separate deliverables using estimated selling price for both delivered and undelivered items when vendor-specific objective evidence or third-party evidence is unavailable. Additional disclosures discussing the nature of multiple element arrangements, the types of deliverables under the arrangements, the general timing of their delivery, and significant factors and estimates used to determine estimated selling prices will be required. This guidance is effective for annual periods beginning after June 15, 2010. We have not yet determined the impact on our consolidated financial statements.

NOTE 3 STOCK-BASED COMPENSATION AND PER SHARE INFORMATION

Stock-Based Compensation

We have three stock-based compensation plans the 1990 Stock Option Plan, the 1993 Stock Option Plan and the 2002 Stock Incentive Plan. The 1990 and 1993 Stock Option Plans have been terminated with respect to granting additional stock options and there are no remaining shares outstanding and exercisable as of September 30, 2010. Under these plans, stock options are awarded to certain officers, directors and employees of the Company at the discretion of the Company s management and/or Board of Directors. Options to employees generally vest on a quarterly basis over three years.

Compensation cost related to stock options recognized in operating results during the three months ended September 30, 2010 and 2009 was $113,000 and $318,000, respectively. The net impact to earnings for those periods was $(0.00) and $(0.01) per basic and diluted share, respectively. Compensation cost related to stock options recognized in operating results during the nine months ended September 30, 2010 and 2009, was $499,000 and $1.1 million, respectively. The net impact to earnings for those periods was $(0.02) and $(0.05) per basic and diluted share, respectively. At September 30, 2010, we had $292,000 of total unrecognized compensation cost, net of estimated forfeitures, related to unvested share-based compensation arrangements granted under our existing plans. We expect that cost to be recognized over a weighted average period of .9 years.

The following table summarizes the income statement classification of compensation expense associated with share-based payments (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Cost of revenue	$ 7	$ 34	$ 26	$ 111
Sales and marketing	40	108	146	336
General and administrative	47	136	259	532
Engineering and development	19	40	68	124
	$ 113	$ 318	$ 499	$ 1,103

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Our options have characteristics significantly different from those of traded options, and changes in the subjective input assumptions can materially affect the fair value estimate. This option pricing model requires us to make several assumptions regarding the key variables used in the model to calculate the fair value of its stock options. The risk-free interest rate used by us is based on the U.S. Treasury yield curve in effect for the expected lives of the options at their dates of grant. Beginning July 1, 2005, we have used a dividend yield of zero as we do not intend to pay dividends on our common stock in the foreseeable future. The most critical assumption used in calculating the fair value of stock options is the expected volatility of our common stock. We believe that the historic volatility of our common stock is a reliable indicator of future volatility, and accordingly, have used a stock volatility factor based on the historical volatility of our common stock over a period of time approximating the estimated lives of our stock options. The expected term is estimated by analyzing our historical share option exercise experience over a five year period. Compensation expense is recognized using the straight-line method for all stock-based awards. Compensation expense is recognized only for those options expected to vest, with forfeitures estimated at the date of grant based on our historical experience and future expectations. Forfeitures are estimated at the time of the grant and revised as necessary in subsequent periods if actual forfeitures differ from those estimates.

The stock option fair values were estimated using the Black-Scholes option-pricing model with the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Expected term (years)	4.60	5.00	4.75	4.96
Volatility	91%	84%	86%	84%
Annual dividend per share	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Risk-free interest rate	1.76%	2.38%	2.18%	2.00%

A summary of option activity under our stock option plans for the nine months ended September 30, 2010 is as follows:

	Shares	Weighted average exercise price	Weighted Average remaining contractual term (years)	Aggregate intrinsic value(1)
Options outstanding at December 31, 2009	3,650,000	$ 4.50		
Plus: Options granted	314,000	$ 1.66		
Less: Options exercised	(167,000)	$ 0.89		
Options canceled or expired	(877,000)	$ 3.04		
Options outstanding at September 30, 2010	2,920,000	$ 4.84	4.17	$ 128,000
Options exercisable at September 30, 2010	2,548,000	$ 5.29	3.45	$ 116,000
Options expired during the nine months ended September 30, 2010	280,000	$ 5.78		

(1)

The intrinsic value calculation does not include negative values. This can occur when the fair market value on the reporting date is less than the exercise price of the grant.

Cash proceeds along with fair value disclosures related to grants, exercises and vesting options are provided in the following table (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Proceeds from stock options exercised	$ 106	$ 139	$ 148	$ 139
Tax benefit related to stock options exercised (1)	N/A	N/A	N/A	N/A
Intrinsic value of stock options exercised (2)	$ 45	$ 82	$ 75	$ 82
Weighted-average fair value of options granted during period	$ 0.85	$ 1.16	$ 1.11	$ .76
Total fair value of shares vested during the period	$ 135	$ 295	$ 494	$ 1,236

(1) Excess tax benefits received related to stock option exercises are presented as financing cash inflows. We currently do not receive a tax benefit related to the exercise of stock options due to our net operating losses.

(2) The intrinsic value of stock options exercised is the amount by which the market price of

the stock on the
date of exercise
exceeded the
market price of
the stock on the
date of grant.

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Warrants

In connection with the Loan and Security Agreement entered into on May 27, 2010, warrants were granted to MidCap Financial and Silicon Valley Bank to purchase up to an aggregate of 101,694 shares of our common stock at a price per share of $1.77. In connection with the Waiver and Amendment No. 1 to the Loan and Security Agreement entered into on September 23, 2010, the purchase price per common stock share of the warrants was amended to the then current market price of $0.84. (See Note 8)

On September 20, 2010, we issued an aggregate of 50,000 warrants to acquire shares of our common stock at a price per share of $0.74, to three of our service providers who provide investor relations services to us. (See Item 2)

Net Income (Loss) Per Share Basic and Diluted

Basic net income (loss) per share is computed by dividing income (loss) available to common stockholders by the weighted-average number of common shares outstanding for the period. In computing diluted net income (loss) per share, the weighted average number of shares outstanding is adjusted to reflect the effect of potentially dilutive securities.

Outstanding stock options and warrants to purchase 3,071,000 shares were not included in the computation of diluted loss per share for the three months ended September 30, 2010 as a result of their anti-dilutive effect. Outstanding stock options to purchase 259,000 shares were included in the computation of diluted earnings per share for the three months ended September 30, 2009. For the same 2009 period, anti-dilutive outstanding stock options and warrants to purchase 3,245,000 shares were not included in the computation of diluted earnings per share.

Outstanding stock options and warrants to purchase 3,071,000 shares were not included in the computation of diluted loss per share for the nine months ended September 30, 2010 as a result of their anti-dilutive effect. Outstanding stock options and warrants to purchase 4,295,000 shares were not included in the computation of diluted loss per share for the nine months ended September 30, 2009 as a result of their anti-dilutive effect.

NOTE 4 INVENTORY

Inventory is valued at the lower of cost or market (determined by the first-in, first-out method) and is comprised of the following (in thousands):

	September 30, 2010	December 31, 2009
Raw materials	$ 4,073	$ 3,400
Work-in-process	1,219	1,497
Finished goods	3,140	2,964
Inventory, net	$ 8,432	$ 7,861

Inventory is net of the valuation adjustment for excess and obsolete inventory of $1.9 million at September 30, 2010 and December 31, 2009.

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NOTE 5 PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment, net is comprised of the following (in thousands):

	September 30, 2010	December 31, 2009
Land	$	$ 273
Building		418
Leasehold improvements	914	914
Equipment and computers	5,909	6,049
Furniture and fixtures	1,019	1,019
Construction in progress	48	45
	7,890	8,718
Accumulated depreciation and amortization	(6,894)	(6,538)
Property, plant and equipment, net	$ 996	$ 2,180

Depreciation and amortization of property, plant and equipment was $226,000 and $732,000 for the three and nine months ended September 30, 2010, respectively, and $318,000 and $1.0 million for the three and nine months ended September 30, 2009, respectively.

Leasehold improvements include $536,000 of tenant improvements paid by the landlord in connection with our primary facility lease.

As a result of transitioning our direct sales in certain countries to Henry Schein, Inc. in early 2009, we began the process of shutting down our foreign operations in those countries. In December 2008, we wrote down the value of our land and building in Germany by $355,000 to reflect the market value of the asset. In June 2010, we agreed to an offer to sell the land and building in Germany for 435,000 or $531,000, and as a result, wrote down the net book value of the assets to net realizable value by 28,000 or $35,000. Fully depreciated assets in the amount of 231,000 or $282,000, which were no longer usable, have also been written off in June 2010. As of September 30, 2010, the land and building are valued at $592,000.

Assets held for sale is comprised of the following (in thousands):

	September 30, 2010
Land	$ 259
Building	333
Assets held for sale	$ 592

NOTE 6 INTANGIBLE ASSETS AND GOODWILL

We conducted our annual impairment analysis of our goodwill and trade names as of June 30, 2010 and concluded there had not been any impairment. Due to current volatility in our stock price caused by adverse equity market conditions and the general economic environment, we closely monitor our stock price and market capitalization and perform such analysis on a quarterly basis. We believe that no triggering events have occurred since June 30, 2010 that would have a material effect on the value of the remaining assets.

We believe no event has occurred that would trigger an impairment of our intangible assets with finite lives that are subject to amortization in 2010. We recorded amortization expense of $33,000 and $98,000 for the three and nine months ended September 30, 2010, respectively, and $32,000 and $108,000, respectively, for the same periods in 2009. Other intangible assets consist of an acquired customer list and a non-compete agreement.

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The following table presents details of the Company s intangible assets, related accumulated amortization and goodwill (in thousands):

	As of September 30, 2010				As of December 31, 2009			
	Gross	Accumulated Amortization	Impairment	Net	Gross	Accumulated Amortization	Impairment	Net
Patents (4-10 years)	$ 1,914	$ (1,540)	$	$ 374	$ 1,914	$ (1,442)	$	$ 472
Trademarks (6 years)	69	(69)			69	(69)		
Trade names (Indefinite life)	979		(979)		979		(979)	
Other (4 to 6 years)	593	(593)			593	(593)		
Total	$ 3,555	$ (2,202)	$ (979)	$ 374	$ 3,555	$ (2,104)	$ (979)	$ 472
Goodwill (Indefinite life)	$ 2,926			$ 2,926	$ 2,926			$ 2,926

NOTE 7 ACCRUED LIABILITIES AND DEFERRED REVENUE

Accrued liabilities are comprised of the following (in thousands):

	September 30, 2010	December 31, 2009
Payroll and benefits	$ 1,038	$ 1,694
Warranty accrual, current portion	2,216	1,787
Deferred rent credit	65	112
Accrued professional services	529	530
Accrued insurance premium		517
Other	485	512
Accrued liabilities	$ 4,333	$ 5,152

Changes in the product warranty accrual, including expenses incurred under our warranties, for the three and nine months ended September 30, 2010 and 2009 were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Initial warranty accrual, beginning balance	$ 2,715	$ 2,132	$ 2,235	$ 2,612
Provision for estimated warranty cost	798	1,072	2,794	2,108
Warranty expenditures	(661)	(994)	(2,177)	(2,510)
Initial warranty accrual, ending balance	2,852	2,210	2,852	2,210
Total warranty accrual, long term	636	452	636	452

Total warranty accrual, current portion	$ 2,216	$ 1,758	$ 2,216	$ 1,758

Deferred revenue is comprised of the following (in thousands):

	September 30, 2010	December 31, 2009
Royalty advances from Procter & Gamble	$ 562	$ 1,875
Undelivered elements (training, installation and product) and other	445	347
Extended warranty contracts	814	876
Total deferred revenue	1,821	3,098
Less long-term amounts:		
Royalty advances from Proctor & Gamble	(375)	(1,875)
Extended warranty contracts	(66)	(100)
Total deferred revenue, long-term	(441)	(1,975)
Total deferred revenue, current portion	$ 1,380	$ 1,123

On August 8, 2006, we entered into a License and Distribution Agreement with Henry Schein, Inc., or HSIC, a large distributor of healthcare products to office-based practitioners, pursuant to which we granted HSIC the exclusive right to distribute our complete line of dental laser systems, accessories and services in the United States and Canada. Concurrent with the execution of the Agreement, HSIC paid an upfront license fee of $5.0 million. The Agreement had an initial term of three years, following which HSIC had the option to extend the Agreement for an additional three-year period under certain circumstances, including its satisfaction of the minimum purchase requirements during the full three-year period, and for an additional license fee of $5.0 million. We amortized the initial $5.0 million payment to *License Fees and Royalty Revenue* on a straight-line basis over the three-year term of the Agreement. Under the Agreement, HSIC was obligated to meet certain minimum purchase requirements and was entitled to receive incentive payments if certain purchase targets were achieved. If HSIC had not met the minimum purchase requirements at the midpoint of each of the first two three-year periods, we would have had the option, upon repayment of a portion of the license fee, to (i) shorten the remaining term of the agreement to one year, (ii) grant distribution rights held by HSIC to other persons (or distribute products itself), (iii) reduce certain discounts on products given to HSIC under the agreement, and (iv) cease paying future incentive payments. We maintain the right to grant certain intellectual property rights to third parties, but by doing so may incur the obligation to refund a portion of the upfront license fee to HSIC.

On May 9, 2007, we entered into an addendum with HSIC, effective as of April 1, 2007, which modified the License and Distribution Agreement to add the terms and conditions under which HSIC has the exclusive right to distribute our *ezlase* diode dental laser system in the United States and Canada. In the Addendum, separate minimum purchase requirements were established for the *ezlase* system. If HSIC had not met the minimum purchase requirement for any 12-month period ending on March 31, we would have had the option, upon 30 days written notice, to (i) convert *ezlase* distribution rights to a non-exclusive basis for a minimum period of one year, after which period we would have had the option to withdraw *ezlase* distribution rights, and (ii) reduce the distributor discount on *ezlase* products.

On March 3, 2008, we entered into a second addendum with HSIC that modified the License and Distribution Agreement, as amended by the first addendum. Pursuant to the second addendum, HSIC was obligated to meet certain minimum purchase requirements and was entitled to receive incentive payments if certain purchase targets were achieved. If HSIC did not meet minimum purchase requirements, we would have had the option to (i) shorten the remaining term of the Agreement to one year, (ii) grant distribution rights held by HSIC to other persons (or distribute products ourselves), (iii) reduce certain discounts on products given to HSIC under the Agreement, and (iv) cease paying future incentive payments. Additionally, under certain circumstances, if HSIC did not meet the minimum purchase requirements, we would have had the right to purchase back the exclusive distributor rights granted to HSIC under the agreement. We also agreed to actively promote Henry Schein Financial Services as our exclusive leasing and financing partner.

On December 23, 2008, we entered into a brief letter agreement with HSIC which amended the initial term of the License and Distribution Agreement to December 31, 2010.

On February 27, 2009, we entered into a letter agreement with HSIC which amended the License and Distribution Agreement, as amended by the first and second addendums and the brief letter agreement. This letter agreement included certain minimum purchase requirements during the initial fourteen-month term of the agreement. In connection with the initial purchase by HSIC made under the letter agreement, on March 13, 2009, we entered into a security agreement, or the March 2009 Security Agreement, with HSIC, granting to HSIC a security interest in our inventory, equipment, and other assets. Pursuant to the March 2009 Security Agreement, the security interest granted was released upon products delivered by us to HSIC in respect of such initial purchase. HSIC also had the option to extend the term of the letter agreement for two additional one-year terms based on certain minimum purchase requirements. In addition, HSIC became our distributor in certain international countries including Germany, Spain, Australia and New Zealand and had first right of refusal in new international markets that we were interested in entering.

On September 10, 2009, we entered into an amendment to the License and Distribution Agreement with HSIC, wherein we agreed to provide to HSIC certain customer warranties in respect of our products.

On January 31, 2010, we entered into a letter agreement amending the License and Distribution Agreement, dated as of August 8, 2006, as amended. Pursuant to the letter agreement, we agreed to an extension of the time for HSIC to provide notice of its intention to renew the License and Distribution Agreement for an additional one year term, from February 1, 2010 to February 25, 2010, in accordance with the terms and conditions thereof.

On February 16, 2010, we entered into a letter agreement amending the License and Distribution Agreement, dated as of August 8, 2006, as amended. Pursuant to the letter agreement, we agreed to HSIC s request to make certain changes to the applicable product categories required to be purchased by HSIC through March 31, 2010, as set forth in the February 27, 2009 letter agreement. The changes included advance payments in respect of, among other things, purchases of the iLase and the provision of upgrades by us to existing products, should such upgrades be made available in the future. In connection with advance payments of $5.8 million we entered into a security agreement, or the February 2010 Security Agreement, with HSIC, granting to HSIC a security interest in our inventory, equipment, and other assets. Pursuant to the February 2010 Security Agreement, the security interest granted was to be released upon products delivered by us to HSIC in respect of such advance payments.

On February 24, 2010, we entered into a letter agreement amending the License and Distribution Agreement, dated as of August 8, 2006, as amended. Pursuant to the letter agreement, we agreed to an extension of the time for HSIC to provide notice of its intention to renew the License and Distribution Agreement for an additional one year term, from February 25, 2010 to March 3, 2010, in accordance with the terms and conditions thereof.

On March 9, 2010, we entered into a letter agreement with HSIC, effective April 1, 2010. The letter agreement called for guaranteed minimum purchases by HSIC of $18 million, payable in semi-monthly payments of $750,000, solely in respect of laser equipment in certain territories, plus additional laser equipment purchases on an uncapped basis in certain other territories, plus incremental purchases of consumable products and services in certain applicable territories. Pursuant to this letter agreement, all dental sales were to be provided exclusively through HSIC in the United Kingdom, Australia, New Zealand, Belgium, Luxembourg, Netherlands, Spain, Germany, Italy, Austria, and North America. This letter agreement provided incentives for HSIC to focus on its core customer base, and allowed us to generate incremental sales to additional dental offices outside of HSIC s core customer base. This letter agreement had an initial term of one year, after which this letter agreement may be extended for a period of six months by mutual agreement. Either party may terminate this letter agreement upon sixty days advance written notice to the other party.

On August 13, 2010, we entered into a letter agreement with HSIC. This letter agreement, effective August 17, 2010, reduced the advance notice required to terminate the March 9, 2010 letter agreement from sixty to forty-five days.

On September 23, 2010, we entered into a Distribution and Supply Agreement, the Agreement, with HSIC, effective August 30, 2010. The Agreement terminated that certain License and Distribution Agreement, dated as of August 8, 2006, as amended, the Terminated Distribution Agreement, which provided for, among other things, exclusive distribution rights for HSIC in North America. Under the Agreement, we granted HSIC certain non-exclusive distribution rights in North America, and in certain other international markets, with respect to our dental laser systems, accessories, and related support and services in certain circumstances. In addition, we granted HSIC exclusivity in selected international markets subject to review of certain performance criteria. In connection with this Agreement, HSIC made prepayments of $3 million and placed an irrevocable $9 million open purchase order for our products, $6 million of which will be for the purchase of the iLase, with an option for an additional $3 million of iLase or for other laser systems. In connection with the advance payment, we agreed to enter into an Amended and Restated Security Agreement, dated September 23, 2010 and with an effective date of August 30, 2010, or the August 2010 Security Agreement, which amended and restated the February 2010 Security Agreement. The August 30, 2010 Security Agreement granted to HSIC a security interest in our inventory and assets as security for advance payment amounts made under the Agreement and the Terminated Distribution Agreement, such security interest to be released by HSIC upon products delivered in respect of the purchase order set forth above. The Agreement has an initial term that ends on December 31, 2013, after which the Agreement will automatically renew for successive one year terms unless certain notice is provided by either party to the other, and HSIC s distribution rights in those territories other than North America shall terminate on December 31, 2012.

In respect of the February 16, 2010 and March 9, 2010 letter agreements with HSIC, and the September 23, 2010 definitive agreement, we have received advance payments totaling $14.8 million, of which $8.4 million remained a customer deposit at September 30, 2010 and will be applied against the open purchase orders.

On June 29, 2006, we received a one-time payment from The Procter & Gamble Company, or P&G, of $3.0 million for a license to certain of our patents pursuant to a binding letter agreement, subsequently replaced by a definitive agreement effective January 24, 2007, or P&G Agreement, which was recorded as deferred revenue when received. In

the event of a material uncured breach of the definitive agreement by us, we could be required to refund certain payments made to us under the P&G Agreement, including the $3.0 million payment. The license fee from P&G was amortized over a two-year period covering January 2007 through December 2008. Additionally, P&G was required to make quarterly payments to us in the amount of $250,000, beginning with a payment for the third quarter of 2006 and continuing until the first product under the agreement is shipped by P&G for large-scale commercial distribution in the United States. Seventy-five percent of each $250,000 payment was treated as prepaid royalties and will be credited against royalty payments owed to us, and the remainder was credited to revenue and represents services provided by BIOLASE to P&G.

Pursuant to the terms of the P&G Agreement, after two years from the effective date of the P&G Agreement, P&G had the right, upon formal notice to us, to elect to convert its exclusive license of our patents into a non-exclusive license (and effectively allow us to license the patents to other parties), and cease making the $250,000 quarterly payments as described above. Pursuant to the P&G Agreement, P&G had forty-five (45) days following the end of each quarter to make the quarterly payment, after which a finance charge was to be assessed, equal to the prime rate of interest then in effect plus 100 basis points. We did not receive quarterly payments in 2009 or 2010 and we did not assess finance charges.

On May 20, 2010, we entered into a License Agreement, the Second Agreement, with P&G with an effective date of January 1, 2009, and which supersedes that certain prior License Agreement, dated January 24, 2007. The Second Agreement amends and modifies the First Agreement so as to enable the Company to launch and market for sale certain light-based oral care devices to dental professionals within the professional market.

Pursuant to the Second Agreement, (i) certain of the prepaid royalties noted above will be released in accordance with the terms and conditions of the Second Agreement, (ii) P&G licensed to the Company certain of P&G s intellectual property, including patents, for the Company s use in the professional dental market, (iii) the Company will pay certain royalties to P&G, expressed as a percentage of net product sales, for the Company s sales of certain light-based oral care devices to dental professionals within the professional market, and (iv) P&G retains certain rights that it had under the First Agreement with regard to certain of the Company s intellectual property for use in the consumer market, as well as related royalties, expressed as a percentage of net product sales, to be paid by P&G to the Company. As a result of the Second Agreement, the prepaid royalty payments previously paid by P&G have been applied to the exclusive license period which is effective as of January 1, 2009 and continues through December 31, 2010. Previously recorded deferred revenue of $1.5 million, which has been applied to the exclusive license arrangement, is being recognized concurrent with the related exclusivity period. As of September 30, 2010, we recognized $1.3 million of licensing revenue. The remaining deferred exclusive license fees will be recognized at $187,500 per quarter through December 31, 2010. As of December 31, 2010, $375,000 will remain in our long term deferred revenue to be applied against future earned royalties.

The Second Agreement will terminate on the date of expiration of the last Company or P&G patent that is licensed to the other party, and the exclusivity of the Company s license to P&G has certain limits and conditions. Additionally, either party may terminate the Second Agreement if there is an uncured material breach of any provision of the Second Agreement by the other party or by mutual consent.

NOTE 8 BANK LINE OF CREDIT AND DEBT

On September 28, 2006, we entered into a Loan and Security Agreement, or the Loan Agreement with Comerica Bank. Under the Loan Agreement, the Lender agreed to extend a revolving loan, the Revolving Line, to us in the maximum principal amount of $10.0 million.

On January 30, 2009, we delivered a compliance certificate to the Lender which set forth the details of our non-compliance with certain covenants under the Loan Agreement as of December 31, 2008. The Loan Agreement was terminated on February 5, 2009 and all outstanding balances were repaid in full with cash available on hand, and under the terms of the Loan Agreement and related note, we and certain of our subsidiaries satisfied all of our obligations under the Loan Agreement.

On May 27, 2010, we entered into a Loan and Security Agreement, the Loan Agreement, with MidCap Financial, LLC, a Delaware limited liability company, and Silicon Valley Bank, a California corporation, the Lenders, for term loan funding of up to $5 million. In connection with the Loan Agreement, we issued two Secured Promissory Notes in favor of the Lenders and two Warrant Agreements in favor of the Lenders for aggregate initial gross proceeds of $3 million. The two Warrant Agreements allow the Lenders to purchase up to an aggregate of 101,694 shares of our common stock at a per share price of $1.77, the Warrants.

On August 3, 2010, MidCap Financial, LLC, assigned our loan to their legal entity, MidCap Funding III, LLC.

On September 23, 2010, we entered into Waiver and Amendment No. 1 to Loan and Security Agreement, the Waiver, with MidCap Funding III, LLC and Silicon Valley Bank, the Lenders. In connection with the Waiver, the Lenders agreed to, among other things, waive non-compliance with a financial covenant under the Loan Agreement, dated as of May 27, 2010, by and between us and the Lenders, specifically with respect to our non-compliance with certain

minimum EBITDA financial covenants. The Waiver contains amendments and additional covenants regarding, among other things, loan amortization, loan prepayment without penalty for certain periods, equity raise covenants, supplemental financial reporting, supplemental cooperation with the Lenders, and additional disclosures and notices. In connection with the Waiver, we entered into an amendment to those certain existing warrants previously issued to the Lenders in connection with the Loan Agreement, which amendment contains a new per share exercise price of $0.84.

Pursuant to the Loan Agreement, the Lenders initially loaned us $3 million. The Loan Agreement included an option, which expired on August 31, 2010, for us to receive an additional $2 million in funding upon the satisfaction of certain conditions, including generating cash from other financing sources.

The outstanding principal balance of the loan bears interest at an annual percentage rate equal to the greater of the thirty (30) day LIBOR rate or three percent, plus nine and one quarter percent. In the event we do not satisfy certain post-closing items, the loan will bear interest at an annual percentage rate equal to the greater of the thirty (30) day LIBOR rate or three percent, plus eleven and one quarter percent. The interest rate will be adjusted each month and interest will be paid monthly. The Loan Agreement, as amended by the Waiver, requires interest only payments for the first four months and beginning in October 2010, the outstanding principal will be repaid in predetermined monthly installments. The final payment of all unpaid principal and accrued interest is due on May 2, 2013, the Maturity Date. Our obligations are secured by substantially all of our assets now owned or hereinafter acquired, including our intellectual property, as well as those of our two wholly-owned subsidiaries, BL Acquisition Corp. and BL Acquisition II, Inc., each of whom have provided a security agreement and certain guarantees to the Lenders. Certain of the assets secured by the security agreement are subordinate to the 2010 Security Agreement in favor of HSIC. As of September 30, 2010, interest on the note is being accrued at a rate of 14.25%. Interest expense, related loan origination fees, prepayment fees and warrant discount costs provided for an effective interest rate on the term loan of 34%.

The Loan Agreement permitted us to prepay the outstanding principal amount and all accrued but unpaid interest and fees, subject to a prepayment fee. The amount of the prepayment fee depended on when the prepayment was made. If prepayment was made on or prior to the first anniversary of the date of the term loan, the prepayment fee was to be equal to six percent of the outstanding principal at the time of prepayment. If prepayment was made after the first anniversary of the term loan and on or prior to the second anniversary of the term loan, the prepayment fee was to be equal to four percent of the outstanding principal at the time of prepayment. If prepayment was made after the second anniversary of the term loan and prior to the Maturity Date, the prepayment fee was to be equal to two percent of the outstanding principal at the time of prepayment. The Waiver provides for prepayment of the Loans on or before March 31, 2011, subject to certain terms, without any prepayment penalty or other fee as stated above.

The Loan Agreement requires certain post-closing covenants and compliance with customary financial and performance covenants and provides for customary events of default. If a default occurs, the Lenders may declare the amounts outstanding under the Loan Agreement immediately due and payable. We did not meet a defined minimum EBITDA test for the period ended June 30, 2010. On August 16, 2010, the Lenders agreed to an interim forbearance period of 15 days as we continue our discussions with the Lenders regarding the performance covenant requirements. On September 23, 2010, the Lenders agreed to waive any non-compliance with our financial covenant requirements through September 30, 2010.

Pursuant to the Loan Agreement, we paid a commitment fee of one-half of one percent of the aggregate $5 million term loan amount, or $25,000. This commitment fee and the legal costs associated with acquiring the loan were capitalized and are being amortized as interest expense, using the effective interest method over the term of the loan. In addition, upon our repayment of the loan, we must pay a final payment fee equal to five percent of the total amount funded under the Loan Agreement which is being accrued and charged to interest expense using the effective interest method over the term of the loan.

In connection with the Loan Agreement, we issued to the Lenders the Warrants. The Warrants are immediately exercisable and may be exercised on a cashless basis. In lieu of exercising these warrants, the holders may convert the warrants into a number of shares, in whole or in part. These warrants will expire if unused on May 26, 2015. The $103,000 estimated fair value of the Warrants was determined by the Black Scholes option pricing model. The Warrants were recorded as equity, resulting in a discount to the Term Loan at issuance. The discount is being amortized to interest expense using the effective interest method over the term of the loan. In connection with the Waiver, we entered into an amendment to those certain existing warrants previously issued to the Lenders in connection with the Loan Agreement, which amendment reduced the new per share exercise price to $0.84. The additional incremental estimated fair value of the Warrants of $12,000 was recorded as equity, resulting in an increase in Loan discount to the Term Loan. The discount is being amortized to interest expense using the effective interest

method over the term of the loan.

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The Waiver provides for additional warrants to be issued to the Lenders in the event that the required Equity Financing does not close on or before March 31, 2011 or if the required Equity Financing results in aggregate net cash proceeds of less than $5 million.

The warrant fair values were estimated using the Black-Scholes option-pricing model with the following assumptions:

Expected term (years)		5.00
Volatility		87%
Annual dividend per share	$	0.00
Risk-free interest rate		1.34%

The components of the term loan payable were as follows:

		September 30, 2010
Term loan payable	$	3,000
Net discount		(97)
Net term loan payable		2,903
Term loan payable, current portion, net of discount		(1,138)
Term loan payable, long-term, net of discount	$	1,765

In December 2009, we financed approximately $573,000 of insurance premiums payable in ten equal monthly installments of approximately $58,000 each, including a finance charge of 3.24%. As of September 30, 2010, there was no amount outstanding under this arrangement.

NOTE 9 COMMITMENTS AND CONTINGENCIES

Litigation

On April 6, 2010, Discus Dental LLC (Discus) and Zap Lasers LLC (Zap) filed a lawsuit against us in the United States District Court for the Central District of California, related to our iLase diode laser. The lawsuit alleges claims for patent infringement, federal unfair competition, common law trademark infringement and unfair competition, and violation of the California Unfair Trade Practices Act.

On May 18, 2010, Discus and Zap filed a First Amended Complaint. The Amended Complaint alleges claims for the same causes of action, but the Amended Complaint dropped an allegation of fraud, as well as certain allegations related to the claims for trademark infringement and unfair competition.

On July 12, 2010, Discus informed the Court that it had acquired all ownership interests in and to Zap and, thus, requested that Zap be dropped as a party to the action. The Court granted that request and, accordingly, Discus is the sole plaintiff in the lawsuit. A jury trial has been scheduled for November 15, 2011.

We intend to vigorously defend the Company against this lawsuit. While, based on the facts presently known, we believe we have meritorious defenses to the claims asserted by Discus, there is no guarantee that we will prevail in this suit or receive any relief if we do prevail. As of September 30, 2010, no amounts have been recorded in the consolidated financial statements for these matters since management believes that it is not probable we have incurred a loss contingency.

From time to time, we become involved in various claims and lawsuits of a character normally incidental to our business. In our opinion, there are no legal proceedings pending against us or any of our subsidiaries that are reasonably expected to have a material adverse effect on our financial condition or on our results of operations.

Supplier Purchase Commitment

We have a long term commitment to a supplier in the amount of $4.5 million for purchases through 2012 or later depending on the terms set forth in an amendment to the supply schedule dated October 1, 2010. There is no purchase commitment that remains for the 2010 year.

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NOTE 10 SEGMENT INFORMATION

We currently operate in a single business segment. For the three and nine months ended September 30, 2010, sales in the United States accounted for approximately 64% and 59% respectively, of net revenue, and international sales accounted for approximately 36% and 41%, respectively, of net revenue. For the three and nine months ended September 30, 2009, sales in the United States accounted for approximately 71% and 74% respectively, of net revenue, and international sales accounted for approximately 29% and 26%, respectively, of net revenue.

Net revenue by geographic location based on the location of customers was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
United States	$ 3,984	$ 8,540	$ 9,739	$ 24,364
International	2,236	3,545	6,768	8,632
	$ 6,220	$ 12,085	$ 16,507	$ 32,996

Long-lived assets located outside of the United States at our foreign subsidiaries, including assets held for sale, were $604,000 and $702,000 million as of September 30, 2010 and December 31, 2009, respectively.

NOTE 11 CONCENTRATIONS

Revenue from our Waterlase systems, our principal product, comprised 31% and 28% of total net revenue for the three and nine months ended September 30, 2010, respectively, and 58% and 55% of total net revenue, respectively, for the same periods in 2009. Revenue from our Diode systems comprised 34% and 26% of total net revenue for the three and nine months ended September 30, 2010, respectively, and 15% and 18%, for the same periods of 2009.

Approximately 46% and 57% of our laser system and consumable products net revenue in the three and nine months ended September 30, 2010 was generated through sales to HSIC worldwide. Approximately 85% and 90% of our laser system and consumable products net revenue in the three and nine months ended September 30, 2009 was generated through sales to HSIC worldwide. There were no sales concentrations greater than 10% within any individual country outside the United States for the three and nine month periods ended September 30, 2010 and 2009.

We maintain our cash and cash equivalents accounts with established commercial banks. Through September 30, 2010, such cash deposits periodically exceeded the Federal Deposit Insurance Corporation insured limit.

Accounts receivable concentrations from HSIC and four other distributors totaled $854,000 and $915,000 or 30% and 34%, respectively, at September 30, 2010. Accounts receivable concentrations from HSIC worldwide totaled $2.5 million or 58% at December 31, 2009.

We currently buy certain key components of our products from single suppliers. Although there are a limited number of manufacturers of these key components, management believes that other suppliers could provide similar key components on comparable terms. A change in suppliers, however, could cause a delay in manufacturing and a possible loss of sales, which would adversely affect consolidated operating results.

NOTE 12 COMPREHENSIVE INCOME (LOSS)

Components of comprehensive income (loss) were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net (loss) income	$ (2,726)	$ 859	$ (12,195)	$ (1,487)
Other comprehensive (loss) income items:				
Foreign currency translation adjustments	227	84	(67)	(7)
Comprehensive (loss) income	$ (2,499)	$ 943	$ (12,262)	$ (1,494)

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NOTE 13 INCOME TAXES

Accounting for Uncertainty in Income Taxes prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. We have elected to classify interest and penalties as a component of our income tax provision. As a result, we recognized a $156,000 liability for unrecognized tax benefits, which was accounted for as an increase in the January 1, 2007 accumulated deficit balance. For the nine months ended September 30, 2010, we recorded an increase of $4,000 in the liability for unrecognized tax benefits, including related estimates of penalties and interest. The liability for unrecognized tax benefits at September 30, 2010 and December 31, 2009 was $157,000 and $153,000, respectively. Such amount is included in other liabilities, long-term in the accompanying consolidated balance sheets.

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CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

This Quarterly Report contains forward-looking statements that involve a number of risks and uncertainties. Forward-looking statements include, but are not limited to, statements pertaining to financial items, plans, strategies or objectives of management for future operations, our financial condition or prospects, and any other statement that is not historical fact, including any statement using terminology such as may, might, will, intend, should, could, would, expect, believe, estimate, predict, potential, plan, or the negativities of these terms or other compar terminology. For all of the foregoing forward-looking statements, we claim the protection of the Private Securities Litigation Reform Act of 1995. These statements are only predictions and actual events or results may differ materially from our expectations for a number of reasons including those set forth under Risk Factors in Item 1A of this quarterly report and our Annual Report on Form 10-K for the year ended December 31, 2009. These forward-looking statements represent our judgment as of the date hereof. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

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

The following discussion of our results of operations and financial condition should be read together with the unaudited consolidated financial statements and the notes to those statements included elsewhere in this report and our audited consolidated financial statements and the notes to those statements for the year ended December 31, 2009. This discussion may contain forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from the results anticipated in any forward-looking statements as a result of a variety of factors, including those discussed in Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2009.

Overview

We are a medical technology company that develops, manufactures and markets lasers and related products focused on technologies for improved applications and procedures in dentistry and medicine. In particular, our principal products provide dental laser systems that allow dentists, periodontists, endodontists, oral surgeons and other specialists to perform a broad range of dental procedures, including cosmetic and complex surgical applications. Our systems are designed to provide clinically superior performance for many types of dental procedures, with less pain and faster recovery times than are generally achieved with drills, scalpels and other dental instruments. We have clearance from the U.S. Food and Drug Administration, or FDA, to market our laser systems in the United States and also have the necessary approvals to sell our laser systems in Canada, the European Union and certain other international markets.

We offer two categories of laser system products: (i) Waterlase systems and (ii) Diode systems. Our flagship product category, the Waterlase system, uses a patented combination of water and laser to perform most procedures currently performed using dental drills, scalpels and other traditional dental instruments for cutting soft and hard tissue. We also offer our diode laser systems to perform soft tissue and cosmetic procedures, including tooth whitening.

On August 8, 2006, we entered into a License and Distribution Agreement, or the Agreement, with Henry Schein, Inc., or HSIC, a large distributor of healthcare products to office-based practitioners, pursuant to which we granted HSIC the exclusive right to distribute our complete line of dental laser systems, accessories and services in the United States and Canada. The Agreement had an initial term of three years, following which it will automatically renew for an additional period of three years, provided that HSIC has achieved its minimum purchase requirements. Under the Agreement, HSIC was obligated to meet certain minimum purchase requirements and was entitled to receive incentive payments if certain purchase targets were achieved. If HSIC had not met the minimum purchase requirements at the midpoint of each of the first two three-year periods, we would have had the option, upon repayment of a portion of the license fee, to (i) shorten the remaining term of the agreement to one year, (ii) grant distribution rights held by HSIC to other persons (or distribute products ourselves), (iii) reduce certain discounts on products given to HSIC under the agreement, and (iv) cease paying future incentive payments. We maintain the right to grant certain intellectual property rights to third parties, but by doing so may incur the obligation to refund a portion of the upfront license fee to HSIC.

On May 9, 2007, we entered into an addendum with HSIC, effective as of April 1, 2007, which modified the License and Distribution Agreement to add the terms and conditions under which HSIC has the exclusive right to distribute our *ezlase* diode dental laser system in the United States and Canada. In the addendum, separate minimum purchase requirements were established for the *ezlase* system. If HSIC had not met the minimum purchase requirement for any 12-month period ending on March 31, we would have had the option, upon 30 days written notice, to (i) convert *ezlase* distribution rights to a non-exclusive basis for a minimum period of one year, after which period we would have had the option to withdraw *ezlase* distribution rights, and (ii) reduce the distributor discount on *ezlase* products.

On March 3, 2008, we entered into a second addendum with HSIC that modified the License and Distribution Agreement, as amended by the first addendum. Pursuant to the second addendum, HSIC was obligated to meet certain minimum purchase requirements and was entitled to receive incentive payments if certain purchase targets were achieved. If HSIC did not meet minimum purchase requirements, we would have had the option to (i) shorten the remaining term of the Agreement to one year, (ii) grant distribution rights held by HSIC to other persons (or distribute products ourselves), (iii) reduce certain discounts on products given to HSIC under the Agreement, and (iv) cease paying future incentive payments. Additionally, under certain circumstances, if HSIC did not meet the minimum purchase requirements, we would have had the right to purchase back the exclusive distributor rights granted to HSIC under the Agreement. We also agreed to actively promote Henry Schein Financial Services as our exclusive leasing and financing partner.

On December 23, 2008, we entered into a brief letter agreement with HSIC which amended the initial term of the License and Distribution Agreement to December 31, 2010.

On February 27, 2009, we entered into a letter agreement with HSIC which amended the License and Distribution Agreement, as amended by the first and second addendums and the brief letter agreement. This letter agreement included certain minimum purchase requirements during the initial fourteen-month term of the agreement. In connection with the initial purchase by HSIC made under the letter agreement, on March 13, 2009 we entered into a security agreement, or March 2009 Security Agreement, with HSIC, granting to HSIC a security interest in our inventory, equipment, and other assets. Pursuant to the March 2009 Security Agreement, the security interest granted was released upon products delivered by us to HSIC in respect of such initial purchase. HSIC also had the option to extend the term of the letter agreement for two additional one-year terms based on certain minimum purchase requirements. In addition, HSIC became our distributor in certain international countries including Germany, Spain, Australia and New Zealand and had first right of refusal in new international markets that we were interested in entering.

On September 10, 2009, we entered into an amendment to the License and Distribution Agreement with HSIC, wherein we agreed to provide to HSIC certain customer warranties in respect of our products.

On January 31, 2010, we entered into a letter agreement amending the License and Distribution Agreement, dated as of August 8, 2006, as amended. Pursuant to the letter agreement, we agreed to an extension of the time for HSIC to provide notice of its intention to renew the License and Distribution Agreement for an additional one year term, from February 1, 2010 to February 25, 2010, in accordance with the terms and conditions thereof.

On February 16, 2010, we entered into a letter agreement amending the License and Distribution Agreement, dated as of August 8, 2006, as amended. Pursuant to the letter agreement, we agreed to HSIC s request to make certain changes to the applicable product categories required to be purchased by HSIC through March 31, 2010, as set forth in the February 27, 2009 letter agreement. The changes included advance payments in respect of, among other things, purchases of the iLase and the provision of upgrades by us to existing products, should such upgrades be made available in the future. In connection with advance payments of $5.8 million we entered into a security agreement, or February 2010 Security Agreement, with HSIC, granting to HSIC a security interest in our inventory, equipment, and other assets. Pursuant to the February 2010 Security Agreement, the security interest granted was to be released upon products delivered by us to HSIC in respect of such advance payments.

On February 24, 2010, we entered into a letter agreement amending the License and Distribution Agreement, dated as of August 8, 2006, as amended. Pursuant to the letter agreement, we agreed to an extension of the time for HSIC to provide notice of its intention to renew the License and Distribution Agreement for an additional one year term, from February 25, 2010 to March 3, 2010, in accordance with the terms and conditions thereof.

On March 9, 2010, we entered into a letter agreement with HSIC, effective April 1, 2010. The letter agreement called for guaranteed minimum purchases by HSIC of $18 million, payable in semi-monthly payments of $750,000, solely in respect of laser equipment in certain territories, plus additional laser equipment purchases on an uncapped basis in certain other territories, plus incremental purchases of consumable products and services in certain applicable territories. Pursuant to this letter agreement, all dental sales were to be provided exclusively through HSIC in the United Kingdom, Australia, New Zealand, Belgium, Luxembourg, Netherlands, Spain, Germany, Italy, Austria, and North America. This letter agreement provided incentives for HSIC to focus on its core customer base, and allowed us

to generate incremental sales to additional dental offices outside of HSIC s core customer base. This letter agreement had an initial term of one year, after which this letter agreement may be extended for a period of six months by mutual agreement. Either party may terminate this letter agreement upon sixty days advance written notice to the other party.

On August 13, 2010, we entered into a letter agreement with HSIC. This letter agreement, effective August 17, 2010, reduced the advance notice required to terminate the March 9, 2010 letter agreement form sixty to forty-five days.

On September 23, 2010, we entered into a Distribution and Supply Agreement, the Agreement, with HSIC, effective August 30, 2010. The Agreement terminated that certain License and Distribution Agreement, dated as of August 8, 2006, as amended, the Terminated Distribution Agreement, which provided for, among other things, exclusive distribution rights for HSIC in North America. Under the Agreement, we granted HSIC certain non-exclusive distribution rights in North America, and in certain other international markets, with respect to our dental laser systems, accessories, and related support and services in certain circumstances. In addition, we granted HSIC exclusivity in selected international markets subject to review of certain performance criteria. In connection with this Agreement, HSIC made prepayments of $3 million and placed an irrevocable $9 million open purchase order for our products, $6 million of which will be for the purchase of the iLase, with an option for an additional $3 million of iLase or for other laser systems. In connection with the advance payment, we agreed to enter into an Amended and Restated Security Agreement, dated September 23, 2010 and with an effective date of August 30, 2010, or the August 2010 Security Agreement, which amended and restated the February 2010 Security Agreement. The August 30, 2010 Security Agreement granted to HSIC a security interest our inventory and assets as security for advance payment amounts made under the Agreement and the Terminated Distribution Agreement, such security interest to be released by HSIC upon products delivered in respect of the purchase order set forth above. The Agreement has an initial term that ends on December 31, 2013, after which the Agreement will automatically renew for successive one year terms unless certain notice is provided by either party to the other, and HSIC s distribution rights in those territories other than North America shall terminate on December 31, 2012.

In respect of the February 16, 2010 and March 9, 2010 letter agreements with HSIC, and the September 23, 2010 definitive agreement, we have received advance payments totaling $14.8 million, of which $8.4 million remained a customer deposit at September 30, 2010 and will be applied against the open purchase orders.

Critical Accounting Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires us to make judgments, assumptions and estimates that affect the amounts reported. The following is a summary of those accounting policies that we believe are necessary to understand and evaluate our reported consolidated financial results.

Revenue Recognition. Effective August 30, 2010, our products are sold domestically directly to customers through our direct sales force and through non-exclusive distributors. Sales are recorded upon shipment from our facility and payment of our invoices is generally due within 30 days or less. Internationally, we sell products through independent distributors including HSIC in certain countries. We recognize revenue based on four basic criteria that must be met before revenue can be recognized: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred and title and the risks and rewards of ownership have been transferred to our customer, or services have been rendered; (iii) the price is fixed or determinable; and (iv) collectability is reasonably assured.

Sales of our laser systems include separate deliverables consisting of the product, disposables used with the laser systems, certain support services, installation and training. For these sales, we apply the residual value method, which requires us to allocate to the delivered elements the total arrangement consideration less the fair value of the undelivered elements. Revenue attributable to the undelivered elements, primarily training, is included in deferred revenue when the product is shipped and is recognized when the related service is performed or upon expiration of time offered under the agreement.

The key judgments related to our revenue recognition relates to the collectability of payment from the customer and the satisfaction of all elements of the arrangement having been delivered and that no additional customer credits and discounts are needed. We evaluate the customer s credit worthiness prior to the shipment of the product. Based on our assessment of the credit information available to us, we may determine the credit risk is higher than normally acceptable, and we will either decline the purchase or defer the revenue until payment is reasonably assured. Future obligations required at the time of sale may cause us to defer the revenue until the obligation is satisfied.

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Although all sales are final, we accept returns of products in certain, limited circumstances and record a provision for sales returns based on historical experience concurrent with the recognition of revenue. The sales returns allowance is recorded as a reduction of accounts receivable and revenue.
We recognize revenue for royalties under licensing agreements for our patented technology when the product using our technology is sold. We estimate and recognize the amount earned based on historical performance and current knowledge about the business operations of our licensees. Our estimates have been consistent with amounts historically reported by the licensees. Licensing revenue related to exclusive licensing arrangements is recognized concurrent with the related exclusivity period.
We may offer sales incentives and promotions on our products. We recognize the cost of sales incentives at the date at which the related revenue is recognized as a reduction in revenue or as a selling expense, as applicable, or later, in the case of incentives offered after the initial sale has occurred.
Accounting for Stock-Based Payments. We generally recognize compensation cost related to all stock-based payments based on the grant-date fair value.
Valuation of Accounts Receivable. We maintain an allowance for uncollectible accounts receivable to estimate the risk of extending credit to customers. We evaluate our allowance for doubtful accounts based upon our knowledge of customers and their compliance with credit terms. The evaluation process includes a review of customers accounts on a regular basis which incorporates input from sales, service and finance personnel. The review process evaluates all account balances with amounts outstanding 90 days and other specific amounts for which information obtained indicates that the balance may be uncollectible. The allowance for doubtful accounts is adjusted based on such evaluation, with a corresponding provision included in general and administrative expenses. Account balances are charged off against the allowance when we feel it is probable the receivable will not be recovered. We do not have any off-balance-sheet credit exposure related to our customers.
Valuation of Inventory. Inventory is valued at the lower of cost, determined using the first-in, first-out method, or market. We periodically evaluate the carrying value of inventory and maintain an allowance for excess and obsolete inventory to adjust the carrying value as necessary to the lower of cost or market. We evaluate quantities on hand, physical condition and technical functionality, as these characteristics may be impacted by anticipated customer demand for current products and new product introductions. Unfavorable changes in estimates of excess and obsolete inventory would result in an increase in cost of revenue and a decrease in gross profit.
Valuation of Long-Lived Assets. Property, plant and equipment, and certain intangibles with finite lives are amortized over their useful lives. Useful lives are based on our estimate of the period that the assets will generate revenue or otherwise productively support our business goals. We monitor events and changes in circumstances which could indicate that the carrying balances of long-lived assets may exceed the undiscounted expected future cash flows from those assets. If such a condition were to exist, we would recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets.
Valuation of Goodwill and Other Intangible Assets. Goodwill and other intangible assets with indefinite lives are not amortized but are tested for impairment annually or whenever events or changes in circumstances indicate that the asset might be impaired. We conducted our annual impairment analysis of our goodwill as of June 30, 2010 and concluded there had been no impairment in goodwill. We closely monitor our stock price and market capitalization and perform such analysis on a quarterly basis. If our stock price and market capitalization declines, we may need to impair our goodwill and other intangible assets.
Warranty Cost. Waterlase systems sold domestically are covered by a warranty against defects in material and workmanship for a period of one year while our diode systems warranty period is up to two years from date of sale to the end-user by us or HSIC. Estimated warranty expenses are recorded as an accrued liability, with a corresponding provision to cost of revenue. Warranty expenses expected to be incurred after one year from the time of sale to the distributor are classified as a long term warranty accrual. This estimate is recognized concurrent with the recognition of revenue on the sale to the distributor. Effective October 1, 2009, Waterlase systems sold internationally are generally covered by a warranty against defects in material and workmanship for a period of sixteen months while our *ezlase* and iLase systems warranty period is up to twenty eight months from date of sale to the international distributor. Our overall accrual is based on our historical experience and our expectation of future conditions. An

increase in warranty claims or in the costs associated with servicing those claims would result in an increase in the accrual and a decrease in gross profit.

Litigation and Other Contingencies. We regularly evaluate our exposure to threatened or pending litigation and other business contingencies. Because of the uncertainties related to the amount of loss from litigation and other business contingencies, the recording of losses relating to such exposures requires significant judgment about the potential range of outcomes. As additional information about current or future litigation or other contingencies becomes available, we will assess whether such information warrants the recording of expense relating to contingencies. To be recorded as expense, a loss contingency must be both probable and reasonably estimable. If a loss contingency is material but is not both probable and estimable, we will disclose the matter in the notes to the consolidated financial statements.

Income Taxes. Based upon our operating losses during 2010 and 2009 and the available evidence, management determined that it is more likely than not that the deferred tax assets as of September 30, 2010 will not be realized, excluding a portion of the foreign deferred tax assets in the amount of $28,000. Consequently, we established a valuation allowance against our net deferred tax asset, excluding a portion of the foreign operations, in the amount of $35.2 and $30.2 million as of September 30, 2010 and December 31, 2009, respectively. In this determination, we considered factors such as our earnings history, future projected earnings and tax planning strategies. If sufficient evidence of our ability to generate sufficient future taxable income tax benefits becomes apparent, we may reduce our valuation allowance, resulting in tax benefits in our statement of operations and in additional paid-in-capital. Management evaluates the potential realization of our deferred tax assets and assesses the need for reducing the valuation allowance periodically.

*Off-Balance Sheet Arrangement*s. We have no off-balance sheet financing or contractual arrangements.

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Results of Operations

The following table presents certain data from our consolidated statements of operations expressed as percentages of revenue:

	Three Months Ended September 30,		Nine Months Ended September 30,	
Consolidated Statements of Operations Data:	2010	2009	2010	2009
Net revenue	100.0%	100.0%	100.0%	100.0%
Cost of revenue	71.2	51.7	75.8	52.4
Gross profit	28.8	48.3	24.2	47.6
Operating expenses:				
Sales and marketing	33.9	18.5	47.4	24.4
General and administrative	21.4	14.0	30.5	18.2
Engineering and development	12.5	8.3	18.1	9.7
Total operating expenses	67.8	40.8	96.0	52.3
(Loss) income from operations	(39.0)	7.5	(71.8)	(4.7)
Non-operating (loss) income, net	(4.4)	(0.4)	(1.8)	0.4
(Loss) income before income tax provision	(43.4)	7.1	(73.6)	(4.3)
Income tax provision	0.4	0.0	0.3	0.2
Net (loss) income	(43.8)%	7.1%	(73.9)%	(4.5)%

The following table summarizes our net revenue by category (dollars in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2010		2009		2010		2009	
Waterlase systems	$ 1,896	31%	$ 7,060	58%	$ 4,586	28%	$ 18,008	55%
Diode systems	2,098	34%	1,767	15%	4,311	26%	5,969	18%
Consumables and Service	2,008	32%	2,969	25%	6,188	37%	7,825	24%
Products and services	6,002	97%	11,796	98%	15,085	91%	31,802	97%
License fee and royalty	218	3%	289	2%	1,422	9%	1,194	3%
Net revenue	$ 6,220	100%	$ 12,085	100%	$ 16,507	100%	$ 32,996	100%

Three months ended September 30, 2010 and 2009

Net Revenue. Net revenue for the three months ended September 30, 2010 was $6.2 million, a decrease of $5.9 million or 48% as compared with net revenue of $12.1 million for the three months ended September 30, 2009.

Laser system net revenue decreased by approximately $4.8 million or 55% in the quarter ended September 30, 2010 compared to the same quarter of 2009. Sales of our Waterlase systems decreased $5.2 million or 73% in the quarter ended September 30, 2010 compared to the same period in 2009 due primarily to an overall reduction in domestic

sales to our primary distributor largely due to their efforts to reduce their inventory. Our Diode family of products increased by $331,000 or 19% in the third quarter of 2010 compared to the same quarter of 2009. The increase resulted primarily from $1.6 million in sales of the iLase offset by decreased ezlase sales both domestically and internationally.

Consumables and service net revenue, which includes consumable products, advanced training programs and extended service contracts, and shipping revenue decreased by approximately $961,000 or 32% for the three months ended September 30, 2010 as compared to the same period of 2009. Consumable products revenue decreased $715,000 or 40% primarily as a result of the decreased sales of the Turbo Upgrade in the quarter ended September 30, 2010 as compared to the same period in 2009. Services revenues decreased $246,000 or 21% as compared to the same period of 2009.

License fees and royalty revenue decreased $71,000 or 25% in the quarter ended September 30, 2010 compared to the same quarter of 2009. The decrease resulted from the amortization of the HSIC license fee in the 2009 offset by the recognition of P&G previously deferred royalty revenue recognized in 2010.

Domestic revenues were $4.0 million, or 64% of net revenue, for the three months ended September 30, 2010 versus $8.5 million, or 71% of net revenue, for the three months ended September 30, 2009. International revenues for the quarter ended September 30, 2010 were $2.2 million, or 36% of net revenue, as compared with $3.5 million, or 29% of net revenue, for the quarter ended September 30, 2009.

Gross Profit. Gross profit for the three months ended September 30, 2010 decreased by $4.0 million from $5.8 million to $1.8 million, and decreased to 29% of net revenue as compared with 48% of net revenue for the three months ended September 30, 2009. The overall decrease in gross profit quarter over quarter was primarily a result of decreased sales revenue in comparison to fixed and unabsorbed manufacturing costs in cost of revenue.

Operating Expenses. Operating expenses for the three months ended September 30, 2010 decreased by $714,000, or 15%, to $4.2 million as compared to $4.9 million for the three months ended September 30, 2009, however they increased as a percentage of net revenue to 68% from 41%. The decrease is primarily due to the cost reductions implemented in the third quarter of 2010. We will continue cost reductions where it makes sense to help offset the negative impact of current economic conditions.

Sales and Marketing Expense. Sales and marketing expenses for the three months ended September 30, 2010 decreased by $121,000, or approximately 5%, to $2.1 million, or 34% of net revenue, as compared with $2.2 million, or 18% of net revenue, for the three months ended September 30, 2009. Conventions and seminars expenses increased $266,000 compared to prior year due to a prior year pickup in expense resulting from a refund. This increase was offset by reduced commission expense of $80,000, reduced payroll and related expenses of $176,000 and reduced travel expenses of $99,000 in the quarter ended September 30, 2010 compared with the same quarter of 2009.

General and Administrative Expense. General and administrative expenses for the three months ended September 30, 2010 decreased by $369,000, or 22%, to $1.3 million, or 21% of net revenue, as compared with $1.7 million, or 14% of net revenue, for the three months ended September 30, 2009. The decrease in general and administrative expenses resulted primarily from decreased payroll and related expenses of $283,000, decreased board fees of $42,000 and decreases in bad debt expense of $47,000.

Engineering and Development Expense. Engineering and development expenses for the three months ended September 30, 2010 decreased by $224,000, or 22%, to $775,000, or 12% of net revenue, as compared with $1.0 million, or 8% of net revenue, for the three months ended September 30, 2009. The decrease is primarily related to decreased payroll and consulting related expenses of $159,000 unrelated to new product development and decreased supplies expense of $51,000 in the quarter ended September 30, 2010 compared with the same quarter of 2009.

Non-Operating Income (Loss)

Gain on Foreign Currency Transactions. We recognized a $118,000 loss on foreign currency transactions for the three months ended September 30, 2010, compared to a $40,000 loss on foreign currency transactions for the three months ended September 30, 2009 due to the changes in exchange rates between the U.S. dollar and the Euro, the Australian dollar and the New Zealand dollar. As we have now transitioned the majority of our sales from through our foreign subsidiaries to sales through third-party distributors, the amount of inter-company transactions and related balances should continue to be reduced in the future.

Interest Income. Interest income resulted from interest earned on our cash and cash equivalents balances. Interest income for the three months ended September 30, 2010 was $1,000 as compared with $1,000 for the three months ended September 30, 2009.

Interest Expense. Interest expense consists primarily of interest on the financing of our business insurance premiums and interest and related debt costs on our term loan which was funded on May 27, 2010. Interest expense for the quarter ended September 30, 2010 was $157,000 as compared to $7,000 for the quarter ended September 30, 2009, an increase of $150,000 which was primarily related to interest and debt costs on our term loan payable.

Income Taxes. An income tax provision of $28,000 was recognized for the three months ended September 30, 2010 as compared with an income tax benefit of $1,000 for the three months ended September 30, 2009. On January 1, 2007, we adopted the interpretations issued by the FASB regarding uncertain tax positions. As a result, we recognized a $156,000 liability for unrecognized tax benefits, including related estimates of penalties and interest, which was accounted for as an increase in the January 1, 2007 accumulated deficit balance. For each of the three months ended

September 30, 2010 and 2009, we recorded an increase of $1,000, in the liability for unrecognized tax benefits, including related estimates of penalties and interest. As of September 30, 2010, we have a valuation allowance against our net deferred tax assets, excluding foreign operations, in the amount of $35.2 million. Based upon our operating losses and the weight of the available evidence, management believes it is more likely than not that we will not realize all of these deferred tax assets.

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Nine months ended September 30, 2010 and 2009

Net Revenue. Net revenue for the nine months ended September 30, 2010 was $16.5 million, a decrease of $16.5 million or 50% as compared with net revenue of $33 million for the nine months ended September 30, 2009. Laser system net revenue decreased by approximately $15.1 million or 63% in the nine months ended September 30, 2010 compared to the same period of 2009. Sales of our Waterlase systems decreased $13.4 million or 75% in the nine months ended September 30, 2010 compared to the same period in 2009 due primarily to an overall reduction in domestic sales to our primary distributor largely due to their efforts to reduce their inventory. Our Diode family of products decreased $1.7 million or 28% in the nine months ended September 30, 2010 compared to the same period of 2009. The decrease resulted primarily from decreased volume sales of the ezlase both domestically and internationally due to our primary distributors efforts to reduce their inventory. This was partially offset by the launch of the iLase with sales of $2.2 million worldwide during 2010. We feel the continued adverse worldwide economic environment has been a significant cause for the decreased sales as well as the change in the purchasing pattern from our distributor.

Consumables and service net revenue decreased by approximately $1.6 million or 21% for the nine months ended September 30, 2010 as compared to the same period of 2009. Consumable products revenue decreased $1.2 million or 28% primarily as a result of the decreased sales of the Turbo Upgrade in the nine months ended September 30, 2010 as compared to the same period in 2009. Services revenues decreased $449,000 or 13% as compared to the same period of 2009.

License fees and royalty revenue increased approximately $228,000 to $1.4 million in the nine months ended September 30, 2010 compared to $1.2 million in the same period of 2009. The 2010 period included $1.3 million of recognized deferred royalties from P&G in accordance with the May 20, 2010 agreement compared to the amortization of the HSIC license fee for the same period in 2009.

Domestic revenues were $9.7 million, or 59% of net revenue, for the nine months ended September 30, 2010 versus $24.4 million, or 74% of net revenue, for the nine months ended September 30, 2009. International revenues for the nine months ended September 30, 2010 were $6.8 million, or 41% of net revenue, as compared with $8.6 million, or 26% of net revenue, for the nine months ended September 30, 2009.

Gross Profit. Gross profit for the nine months ended September 30, 2010 decreased by $11.7 million to $4.0 million, or 24% of net revenue, as compared with gross profit of $15.7 million, or 48% of net revenue, for the nine months ended September 30, 2009. The overall decrease was primarily due to lower sales volumes in comparison to fixed and unabsorbed manufacturing costs in cost of revenue. This was partially offset by net increase in revenue recognized on deferred royalties from P&G.

Operating Expenses. Operating expenses for the nine months ended September 30, 2010 decreased by $1.4 million or 8%, to $15.8 million as compared to $17.2 million for the nine months ended September 30, 2009 but increased as a percentage of net revenue to 96% from 52% on lower net revenue from period to period. We continue to implement cost reductions to help offset the negative impact of current economic conditions.

Sales and Marketing Expense. Sales and marketing expenses for the nine months ended September 30, 2010 decreased by $221,000, or approximately 3%, to $7.8 million, or 47% of net revenue, as compared with $8.1 million, or 24% of net revenue, for the nine months ended September 30, 2009. Major factors contributing to the reduction were a decrease in payroll and consulting related expenses of $459,000 and a commission expense decrease of $313,000 offset by increased travel and entertainment of $42,000 and an increase in advertising and product literature related expenses of $514,000 related primarily to the launch of the iLase in the nine months ended September 30, 2010 compared with the same period of 2009.

General and Administrative Expense. General and administrative expenses for the nine months ended September 30, 2010 decreased by $1.0 million, or 16%, to $5.0 million, as compared with $6.0 million for the nine months ended September 30, 2009, but increased as a percentage of net revenue to 30% from 18% on lower net revenue from period to period. The decrease in general and administrative expenses resulted primarily from decreased payroll and consulting related expenses of $1.1 million, decreased depreciation expenses of $197,000 and decreased audit fees of $97,000. These decreases were partially offset by an increase in provision for bad debt of $84,000 due to previously determined uncollectible accounts in 2009 becoming collectible, increased legal and patent related fees of $200,000 and an increase in investor relations and board fees of $114,000 partially due to the board waving their Q1 Board Fees in 2009.

Engineering and Development Expense. Engineering and development expenses for the nine months ended September 30, 2010 decreased by $211,000 or 7%, to $3.0 million, as compared with $3.2 million for the nine months ended September 30, 2009, but increased as a percentage of net revenue to 18% from 10% on lower net revenue from period to period. The increase in depreciation expense of $56,000 related to purchases of molds and tooling for the iLase was offset by a decrease in payroll and consulting related expenses of $279,000.

Non-Operating Income (Loss)

Gain on Foreign Currency Transactions. We recognized a $75,000 loss on foreign currency transactions for the nine months ended September 30, 2010, compared to a $166,000 gain on foreign currency transactions for the nine months ended September 30, 2009 due to the changes in exchange rates between the U.S. dollar and the Euro, the Australian dollar and the New Zealand dollar. As we have now transitioned most of our sales from our foreign subsidiaries to sales through third party distributors, the amount of inter-company transactions and related balances should be reduced in the future.

Interest Income. Interest income resulted from interest earned on our cash and cash equivalents balances. Interest income for the nine months ended September 30, 2010 was $2,000 as compared with $4,000 for the nine months ended September 30, 2009. The decrease is the result of lower average cash balances during the 2010 period compared to the same period in 2009.

Interest Expense. Interest expense consists primarily of interest on the financing of our business insurance premiums and interest and related debt costs on outstanding balances on our term loan payable. Interest expense for the nine months ended September 30, 2010 was $216,000 as compared to $49,000 for the nine months ended September 30, 2009. Interest expense, including amortization of loan costs and debt discounts related to our loan payable was $208,000 in the nine months ended September 30, 2010 as compared to interest expense of $42,000 in the nine months ended September 30, 2009 related to our previous line of credit that was paid in full on February 5, 2009.

Income Taxes. An income tax provision of $52,000 was recognized for the nine months ended September 30, 2010 as compared with $57,000 for the nine months ended September 30, 2009. On January 1, 2007, we adopted the interpretations issued by the FASB regarding uncertain tax positions. As a result, we recognized a $156,000 liability for unrecognized tax benefits, including related estimates of penalties and interest, which was accounted for as an increase in the January 1, 2007 accumulated deficit balance. For each of the nine months ended September 30, 2010 and 2009, we recorded an increase of $5,000, in the liability for unrecognized tax benefits, including related estimates of penalties and interest. As of September 30, 2010, we have a valuation allowance against our net deferred tax assets, excluding foreign operations, in the amount of $35.2 million. Based upon our operating losses and the weight of the available evidence, management believes it is more likely than not that we will not realize all of these deferred tax assets.

Liquidity and Capital Resources

We have incurred significant net losses and net revenue has declined during the past three years. As of September 30, 2010, we had $2.2 million in cash and cash equivalents to finance operations and satisfy our obligations. On September 23, 2010, we entered into a new distribution agreement (See Note 7) with HSIC, effective August 30, 2010, that changed our distributor relationship with HSIC from an exclusive to a non-exclusive distributor of our products. Under the Agreement, we granted HSIC certain non-exclusive distribution rights in North America, and in other international markets, with respect to our dental laser systems, accessories, and related support and services in certain circumstances. In addition, we granted HSIC exclusivity in selected international markets subject to review of

certain performance criteria. In connection with this agreement, HSIC made prepayments of $3 million and placed an irrevocable $9 million open purchase order for our products, $6 million of which will be for the purchase of the iLase, with an option for an additional $3 million of iLase or for other laser systems. In respect of the February 16, 2010 and March 9, 2010 letter agreements with HSIC, and the September 23, 2010 definitive agreement, we have received advance payments totaling $14.8 million, of which $8.4 million remained a customer deposit at September 30, 2010 and will be applied against the open purchase orders.

On May 27, 2010 we entered into a Loan and Security Agreement in respect of a $5 million term loan, $3 million was funded on such date. On September 23, 2010 we entered into Waiver and Amendment No. 1 to the Loan and Security Agreement which, among other things, waived our non-compliance at June 30, 2010 and September 30, 2010 with a financial covenant contained in the Loan and Security Agreement. (See Note 8) In addition to the loan funding we received, we implemented cost cutting measures in the second and third quarters of 2010 which included a reduction in headcount of approximately 25 full time employees. Our ability to meet our obligations in the ordinary course of business is dependent upon our ability to sell our products directly to the end-user and through distributors, raise additional financing through public or private equity or debt financing, to establish profitable operations through increased sales and decreased expenses, or to secure other sources of financing to fund operations. Management intends to seek to increase sales through the efforts of our direct sales force and through our distributor relationships domestically and around the world. However, there can be no assurance we will be able to increase sales, reduce expenses or line up new financing sources.

The accompanying financial statements have been prepared on a going concern basis that contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The financial statements do not include adjustments relating to the recoverability of recorded asset amounts or the amounts or classification of liabilities that might be necessary should we be unable to continue as a going concern.

On February 16, 2010, we entered into a letter agreement amending the License and Distribution Agreement, dated as of August 8, 2006, as amended. Pursuant to the letter agreement, we agreed to HSIC s request to make certain changes to the applicable product categories required to be purchased by HSIC through March 31, 2010, as set forth in the February 27, 2009 letter agreement. The changes included advance payments in respect of, among other things, purchases of the iLase, and the provision of upgrades by us to existing products, should such upgrades be made available in the future. In connection with advance payments of $5.8 million we entered into a security agreement, or February 2010 Security Agreement, with HSIC, granting to HSIC a security interest in our inventory, equipment, and other assets. Pursuant to the February 2010 Security Agreement, the security interest granted was to be released upon products delivered by us to HSIC in respect of such advance payments.

On February 24, 2010, we entered into a letter agreement amending the License and Distribution Agreement, dated as of August 8, 2006, as amended. Pursuant to the letter agreement, we agreed to an extension of the time for HSIC to provide notice of its intention to renew the License and Distribution Agreement for an additional one year term, from February 25, 2010 to March 3, 2010, in accordance with the terms and conditions thereof.

On March 9, 2010, we entered into a letter agreement with HSIC, effective April 1, 2010. The letter agreement called for guaranteed minimum purchases by HSIC of $18 million, payable in semi-monthly payments of $750,000, solely in respect of laser equipment in certain territories, plus additional laser equipment purchases on an uncapped basis in certain other territories, plus incremental purchases of consumable products and services in certain applicable territories. Pursuant to this letter agreement, all dental sales were to be provided exclusively through HSIC in the United Kingdom, Australia, New Zealand, Belgium, Luxembourg, Netherlands, Spain, Germany, Italy, Austria, and North America. This letter agreement provided incentives for HSIC to focus on its core customer base, and allowed us to generate incremental sales to additional dental offices outside of HSIC s core customer base. This letter agreement had an initial term of one year, after which this letter agreement may be extended for a period of six months by mutual agreement. Either party may terminate this letter agreement upon sixty days advance written notice to the other party.

On August 13, 2010, we entered into a letter agreement with HSIC. This letter agreement, effective August 17, 2010, reduces the advance notice required to terminate the March 9, 2010 letter agreement form sixty to forty-five days.

On September 23, 2010, we entered into a Distribution and Supply Agreement, the Agreement, with HSIC, effective August 30, 2010. The Agreement terminated that certain License and Distribution Agreement, dated as of August 8, 2006, as amended, the Terminated Distribution Agreement, which provided for, among other things, exclusive distribution rights for HSIC in North America. Under the Agreement, we granted HSIC certain non-exclusive distribution rights in North America, and in certain other international markets, with respect to our dental laser systems, accessories, and related support and services in certain circumstances. In addition, we granted HSIC exclusivity in selected international markets subject to review of certain performance criteria. In connection with this Agreement, HSIC made prepayments of $3 million and placed an irrevocable $9 million open purchase order for our

products, $6 million of which will be for the purchase of the iLase, with an option for an additional $3 million of iLase or for other laser systems. In connection with the advance payment, we agreed to enter into an Amended and Restated Security Agreement, dated September 23, 2010 and with an effective date of August 30, 2010, or the August 2010 Security Agreement, which amended and restated the February 2010 Security Agreement. The August 30, 2010 Security Agreement granted to HSIC a security interest in our inventory and assets as security for advance payment amounts made under the Agreement and the Terminated Distribution Agreement, such security interest to be released by HSIC upon products delivered in respect of the purchase order set forth above. The Agreement has an initial term that ends on December 31, 2013, after which the Agreement will automatically renew for successive one year terms unless certain notice is provided by either party to the other, and HSIC s distribution rights in those territories other than North America shall terminate on December 31, 2012.

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In respect of the February 16, 2010 and March 9, 2010 letter agreements with HSIC, and the September 23, 2010 definitive agreement, we have received advance payments totaling $14.8 million, of which $8.4 million remained a customer deposit at September 30, 2010 and will be applied against the open purchase orders.

As of March 31, 2010, HSIC had fulfilled its obligation for minimum payments of $42.7 million under the February 27, 2009 letter agreement. As of September 30, 2010, HSIC has fulfilled its guaranteed minimum purchase obligations and related prepayments to date per the March 9, 2010 letter agreement as superseded by the September 23, 2010 agreement. Although we believe the level of HSIC s inventory was reduced in the first nine months of 2010, we believe that HSIC s inventory remains above historical levels.

At September 30, 2010, we had negative net working capital of $4.5 million, a decrease of $9.8 million from $5.3 million in net working capital at December 31, 2009 resulting primarily from increased customer deposits of $8.4 million and a term loan payable of $1.1 million which was partially offset by increased inventory balances of $571,000. Our principal sources of liquidity at September 30, 2010 consisted of our cash and cash equivalents balance of $2.2 million.

On September 28, 2006, we entered into a Loan and Security Agreement, or the Loan Agreement with Comerica Bank. Under the Loan Agreement, the Lender agreed to extend a revolving loan, the Revolving Line, to us in the maximum principal amount of $10.0 million.

On January 30, 2009, we delivered a compliance certificate to the Lender which set forth non-compliance with certain covenants under the Loan Agreement as of December 31, 2008. The loan agreement was terminated on February 5, 2009 and all outstanding balances were repaid in full with cash available on hand, and under the terms of the Loan Agreement and related note, we and certain of our subsidiaries satisfied all of our obligations under the Loan Agreement.

On May 27, 2010, we entered into a Loan and Security Agreement, the Loan Agreement, with MidCap Financial, LLC, a Delaware limited liability company, and Silicon Valley Bank, a California corporation, collectively, the Lenders, for term loan funding of up to $5 million. In connection with the Loan Agreement, we issued two Secured Promissory Notes in favor of the Lenders and two Warrant Agreements in favor of the Lenders for aggregate initial gross proceeds of $3 million. The two Warrant Agreements allow the Lenders to purchase up to an aggregate of 101,694 shares of our common stock at a per share price of $1.77, the Warrants.

On August 3, 2010, MidCap Financial, LLC, assigned our loan to their legal entity, MidCap Funding III, LLC.

On September 23, 2010, we entered into Waiver and Amendment No. 1 to Loan and Security Agreement, the Waiver, with MidCap Funding III, LLC and Silicon Valley Bank, the Lenders. In connection with the Waiver, the Lenders agreed to, among other things, waive non-compliance with a financial covenant under the Loan Agreement, dated as of May 27, 2010, by and between us and the Lenders, specifically with respect to our non-compliance with certain minimum EBITDA financial covenants. The Waiver contains amendments and additional covenants regarding, among other things, loan amortization, loan prepayment without penalty for certain periods, equity raise covenants, supplemental financial reporting, supplemental cooperation with the Lenders, and additional disclosures and notices. In connection with the Waiver, we entered into an amendment to those certain existing warrants previously issued to the Lenders in connection with the Loan Agreement, which amendment contains a new per share exercise price of $0.84.

Pursuant to the Loan Agreement, the Lenders initially loaned us $3 million. The Loan Agreement included an option, which expired on August 31, 2010, for us to receive an additional $2 million in funding upon the satisfaction of certain conditions, including generating cash from other financing sources.

The outstanding principal balance of the loan bears interest at an annual percentage rate equal to the greater of the thirty (30) day LIBOR rate or three percent, plus nine and one quarter percent. In the event we do not satisfy certain post-closing items, the loan will bear interest at an annual percentage rate equal to the greater of the thirty (30) day LIBOR rate or three percent, plus eleven and one quarter percent. The interest rate will be adjusted each month and interest will be paid monthly. The Loan Agreement, as amended by the Waiver, requires interest only payments for the first four months and beginning in October 2010, the outstanding principal will be repaid in predetermined monthly installments. The final payment of all unpaid principal and accrued interest is due on May 2, 2013, the Maturity Date. Our obligations are secured by substantially all of our assets now owned or hereinafter acquired,

including our intellectual property, as well as those of our two wholly-owned subsidiaries, BL Acquisition Corp. and BL Acquisition II, Inc., each of whom have provided a security agreement and certain guarantees to the Lenders. Certain of the assets secured by the security agreement are subordinate to the 2010 Security Agreement in favor of HSIC. As of September 30, 2010, interest on the note is being accrued at a rate of 14.25%. Interest expense, related loan origination fees, prepayment fees and warrant discount costs provided for an effective interest rate on the term loan of 34%.

The Loan Agreement permitted us to prepay the outstanding principal amount and all accrued but unpaid interest and fees, subject to a prepayment fee. The amount of the prepayment fee depended on when the prepayment was made. If prepayment was made on or prior to the first anniversary of the date of the term loan, the prepayment fee was to be equal to six percent of the outstanding principal at the time of prepayment. If prepayment was made after the first anniversary of the term loan and on or prior to the second anniversary of the term loan, the prepayment fee was to be equal to four percent of the outstanding principal at the time of prepayment. If prepayment was made after the second anniversary of the term loan and prior to the Maturity Date, the prepayment fee was to be equal to two percent of the outstanding principal at the time of prepayment. The Waiver provides for prepayment of the Loans on or before March 31, 2011, subject to certain terms, without any prepayment penalty or other fee as stated above.

The Loan Agreement requires certain post-closing covenants and compliance with customary financial and performance covenants and provides for customary events of default. If a default occurs, the Lenders may declare the amounts outstanding under the Loan Agreement immediately due and payable. We did not meet a defined minimum EBITDA test for the period ended June 30, 2010. On August 16, 2010, the Lenders agreed to an interim forbearance period of 15 days as we continue our discussions with the Lenders regarding the performance covenant requirements. On September 23, 2010, the Lenders agreed to waive any non-compliance with our financial covenant requirements through September 30, 2010.

Pursuant to the Loan Agreement, we paid a commitment fee of one-half of one percent of the aggregate $5 million term loan amount, or $25,000. This commitment fee and the legal costs associated with acquiring the loan were capitalized and are being amortized as interest expense using the effective interest method over the term of the loan. In addition, upon our repayment of the loan, we must pay a final payment fee equal to five percent of the total amount funded under the Loan Agreement which is being accrued and charged to interest expense using the effective interest method over the term of the loan.

In connection with the Loan Agreement, we issued to the Lenders the Warrants. The Warrants are immediately exercisable and may be exercised on a cashless basis. In lieu of exercising these warrants, the holders may convert the warrants into a number of shares, in whole or in part. These warrants will expire if unused on May 26, 2015. The $103,000 estimated fair value of the Warrants was determined by the Black Scholes option pricing model. The Warrants were recorded as equity, resulting in a discount to the Term Loan at issuance. The discount is being amortized to interest expense using the effective interest method over the term of the loan. In connection with the Waiver, we entered into an amendment to those certain existing warrants previously issued to the Lenders in connection with the Loan Agreement, which amendment contains a new per share exercise price of $0.84. The additional incremental estimated fair value of the Warrants of $12,000 was recorded as equity, resulting in an increase in Loan discount to the Term Loan. The discount is being amortized to interest expense using the effective interest method over the term of the loan.

For the nine months ended September 30, 2010, our operating activities used cash of approximately $3.6 million compared to cash used of $1.8 million for the nine months ended September 30, 2009. Cash flows from operating activities in the quarter ended September 30, 2010 were negatively impacted by the net loss recorded in the period offset by an $8.4 million customer deposit from HSIC. The most significant changes in operating assets and liabilities for the nine months ended September 30, 2010 as reported in our consolidated statements of cash flows were decreases of $1.4 million in accounts receivable (before the change in allowance for doubtful accounts) and an $8.4 million increase in customer deposits offset by a decrease in accounts payable and accrued liabilities of $1.2 million.

In December 2009, we financed approximately $573,000 of insurance premiums payable in ten equal monthly installments of approximately $58,000 each, including a finance charge of 3.24%. On January 10, 2006, we entered into a five-year facility lease with initial monthly installments of $39,000 and annual adjustments over the lease term. On September 24, 2009, we entered into a First Amendment to Lease which extended the facility lease term to April 20, 2015, adjusted basic rent and made modification provisions to the security deposit. These amounts are included in the outstanding obligations as of September 30, 2010 listed below.

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The following table presents our expected cash requirements for contractual obligations outstanding as of September 30, 2010 for the years ending as indicated below (in thousands):

	Less Than 1 Year	1 to 3 Years	3 to 5 Years	More Than 5 years	Total
Operating leases	$ 507	$ 981	$ 820	$	$ 2,308
SurgiLight agreement	25				25
Insurance premium financing					
Total	$ 532	$ 981	$ 820	$	$ 2,333

In addition and not included in the above table is a long term commitment to a supplier in the amount of $4.5 million for purchases through 2012.

In conjunction the resignation by a member from our Board of Directors, we agreed to a consulting agreement, the terms to be determined, for $6,250 per month in exchange for certain specific services to be performed. Such services have not been performed as of September 30, 2010, and no definitive consulting agreement has ever been signed.

In January 2008, Jake St. Philip was appointed our Chief Executive Officer. On March 5, 2009, Mr. St. Philip resigned as our Chief Executive Officer and as a director of our Board of Directors. On March 10, 2009, we entered into a Separation and General Release Agreement, or Agreement, with Mr. St. Philip. Pursuant to the Agreement, we agreed to pay Mr. St. Philip a severance payment of $350,000 of which half was paid on May 9, 2009 and half was paid in twelve consecutive equal monthly installments commencing on June 1, 2009. In addition, we paid COBRA premiums on his behalf for twelve months. The Agreement superseded the Employment Agreement we had with Mr. St. Philip dated January 2, 2008.

On April 30, 2008, we appointed David M. Mulder as Chief Financial Officer. Mr. Mulder had an employment agreement that obligated us to pay him severance benefits under certain conditions, including termination without cause and resignation with good reason. In the event Mr. Mulder was terminated by us without cause or he resigns with good reason, the total severance benefits payable would be approximately $255,000 based on compensation in effect as of April 30, 2008, the date Mr. Mulder was appointed as our then Chief Financial Officer. On March 5, 2009, Mr. Mulder was appointed Chief Executive Officer and appointed to our Board of Directors. On April 3, 2009, we modified the financial terms of Mr. Mulder s employment with us, in connection with his appointment to the position of Chief Executive Officer. Under the new terms of Mr. Mulder s employment, in the event he was terminated by us without cause or he resigns with good reason, we agreed to pay Mr. Mulder his base salary then in effect (or $250,000, his new base salary as modified on April 3, 2009) payable in twenty-four equal semi-monthly installments. In addition, we agreed to pay Mr. Mulder s COBRA premiums for twelve months. On June 10, 2010, Mr. Mulder was appointed President and Chairman of the Board. On August 24, 2010, Mr. Mulder resigned from his position as Chairman, CEO and President and as a member of our Board of Directors. On August 24, 2010, the Company entered into a Separation Agreement, or Agreement, with Mr. Mulder. Pursuant to the Agreement, we agreed to pay Mr. Mulder a severance payment of $10,416.67, payable in one installment, and COBRA premiums on his behalf for six months. The agreement superseded the severance provisions contained in the Employment Agreement, as amended, that we had with Mr. Mulder under the previous agreement.

On July 14, 2009, we appointed Brett L. Scott as Chief Financial Officer. Mr. Scott had an employment agreement that obligated us to pay him severance benefits under certain conditions, including termination without cause and resignation with good reason. In the event Mr. Scott was terminated by us without cause or he resigns with good reason, the total severance benefits payable would be approximately $102,500 based on the employment agreement in effect as of July 14, 2009. In addition, we agreed to pay Mr. Scott s COBRA premiums for six months. On July 6, 2010, Mr. Scott resigned from his position as our Chief Financial Officer. On July 6, 2010, we entered into a Separation Agreement, or Agreement, with Mr. Scott. Pursuant to the Agreement, we agreed to pay Mr. Scott a severance payment of $17,500, payable in two consecutive installments. In addition, we agreed to pay COBRA premiums on his behalf for three months. The Agreement superseded the severance provisions contained in the

Employment Agreement we had with Mr. Scott dated July 14, 2009.

On June 10, 2010, Mr. Federico Pignatelli was terminated as President of the Company. On July 1, 2010, Mr. Pignatelli was appointed Vice Chairman of the Board of Directors. In connection with such appointment, Mr. Pignatelli agreed to $1 cash compensation and 35,000 shares of Stock Options in lieu of the cash compensation paid to our Directors. We also agreed to reimburse Mr. Pignatelli for $50,000 of his out-of-pocket legal fees and expenses incurred in conjunction with stockholder activities. On August 24, 2010, Mr. Pignatelli was appointed Executive Chairman of the Board and Interim Chief Executive Officer of the Company. On September 30, 2010, Mr. Pignatelli was appointed the permanent Chief Executive Officer of the Company.

Certain members of management are entitled to severance benefits payable upon termination following a change in control, which would approximate $1.2 million. Also, we have agreements with certain employees to pay bonuses based on targeted performance criteria.

In addition to the amounts shown in the table above, $109,000 of unrecognized tax benefits have been recorded as liabilities, and we are uncertain as to if or when such amounts may be settled. Related to these unrecognized tax benefits, we have also recorded a liability for potential penalties and interest of $20,000 and $28,000, respectively, at September 30, 2010. The liability for unrecognized tax benefits at September 30, 2010 and December 31, 2009 was $157,000 and $153,000, respectively.

Our capital requirements will depend on many factors, including, among other things, the effects of any acquisitions we may pursue as well as the rate at which our business grows, with corresponding demands for working capital and manufacturing capacity. We could be required or may elect to seek additional funding through public or private equity or debt financing. However, a credit facility, or additional funds through public or private equity or other debt financing, may not be available on terms acceptable to us or at all. Without additional funds and/or increased revenues, we may not have enough cash/financial resources to operate for the next twelve months.

Subsequent Event

On October 15, 2010, we received notice that we had regained compliance with the minimum stockholders equity requirement for continued listing on The Nasdaq Capital Market.

Recent Accounting Pronouncements

See Note 2 of the Notes to Consolidated Financial Statements (Unaudited) included in this report for a discussion on recent accounting pronouncements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Substantially all of our revenue is denominated in U.S. dollars, including sales to our international distributors. Only a small portion of our revenue and expenses is denominated in foreign currencies, principally the Euro. Our Euro expenditures primarily consist of the cost of maintaining our office in Germany, including the facility and employee-related costs. To date, we have not entered into any hedging contracts. Future fluctuations in the value of the U.S. dollar may, however, affect the price competitiveness of our products outside the United States.

Through February 5, 2009, we had a line of credit which bore interest at rates based on the Prime Rate or LIBOR. The line of credit was terminated on February 5, 2009 and the balance was repaid in full.

On May 27, 2010 we entered into a Loan and Security Agreement, the Loan Agreement, with MidCap Financial, LLC, a Delaware limited liability company, and Silicon Valley Bank, a California corporation, the Lenders, for term loan funding of up to $5 million, $3 million of which was funded immediately and bore interest at an annual percentage rate equal to the greater of the thirty (30) day LIBOR rate or three percent, plus eleven and one quarter percent or 14.25% . This agreement was amended on September 23, 2010.

Our primary objective in managing our cash balances has been preservation of principal and maintenance of liquidity to meet our operating needs. Most of our excess cash balances are invested in money market accounts in which there is minimal interest rate risk.

ITEM 4. CONTROLS AND PROCEDURES.

Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and principal financial and accounting officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2010. Based on this evaluation, our chief executive officer and principal financial and accounting officer concluded that our disclosure controls and procedures were effective as of September 30, 2010.

Changes in Internal Control over Financial Reporting

In our Annual Report on Form 10-K for the year ended December 31, 2009, we disclosed management s assessment that our internal control over financial reporting contained no material weaknesses. No change in internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) occurred in 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION.

ITEM 1. LEGAL PROCEEDINGS.

On April 6, 2010, Discus Dental LLC (Discus) and Zap Lasers LLC (Zap) filed a lawsuit against us in the United States District Court for the Central District of California, related to our iLase diode laser. The lawsuit alleges claims for patent infringement, federal unfair competition, common law trademark infringement and unfair competition, and violation of the California Unfair Trade Practices Act.

On May 18, 2010, Discus and Zap filed a First Amended Complaint. The Amended Complaint alleges claims for the same causes of action, but the Amended Complaint dropped an allegation of fraud, as well as certain allegations related to the claims for trademark infringement and unfair competition.

On July 12, 2010, Discus informed the Court that it had acquired all ownership interests in and to Zap and, thus, requested that Zap be dropped as a party to the action. The Court granted that request and, accordingly, Discus is the sole plaintiff in the lawsuit. A jury trial has been scheduled for November 15, 2011.

We intend to vigorously defend the Company against this lawsuit. While, based on the facts presently known, we believe we have meritorious defenses to the claims asserted by Discus, there is no guarantee that we will prevail in this suit or receive any relief if we do prevail. As of September 30, 2010, no amounts have been recorded in the consolidated financial statements for these matters since management believes that it is not probable we have incurred a loss contingency.

From time to time, we become involved in various claims and lawsuits of a character normally incidental to our business. In our opinion, there are no legal proceedings pending against us or any of our subsidiaries that are reasonably expected to have a material adverse effect on our financial condition or on our results of operations.

ITEM 1A. RISK FACTORS.

Our business, financial condition, and results of operations can be impacted by a number of risk factors, any one of which could cause our actual results to vary materially from recent results or from our anticipated future results. The discussion of our business and operations should be read together with the risk factors below and those contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 which was filed with the SEC, and our Quarterly Report on Form 10-Q for the fiscal quarters ended March 31, 2010 and June 30, 2010 which was filed with the SEC, and describe the various risks and uncertainties to which we are or may be subject. Any of these risks could materially and adversely affect our business, financial condition and results of operations, which in turn could materially and adversely affect the price of our common stock or other securities.

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

On September 20, 2010, we issued warrants to acquire shares of our common stock to three of our service providers who provide investor relations services to us, in exchange for the provision of certain investor relations services without registration under the Securities Act of 1933, or the Act, in reliance on the exemption provided in Section 4(2) of the Act. The warrants will vest equally over four consecutive quarters. The following table shows the date of this issuance, the number of warrant shares issued, and the number of shares of our common stock exercisable, and the strike price of each warrant share.

Name	Date of Issuance	Number of Warrants	Shares of Common Stock Exercisable	Strike Price
Christopher Mark Rosgen	9/20/2010	24,000	24,000	$ 0.74
Allen and Caron Inc.	9/20/2010	10,000	10,000	$ 0.74
Alpenglow Ranch Inc.	9/20/2010	16,000	16,000	$ 0.74

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ITEM 6. EXHIBITS

Exhibit No.	Description
10.1	Settlement Agreement, dated July 6, 2010, by and between Biolase Technology, Inc. and Brett Scott.
10.2	Letter Agreement, dated August 13, 2010, by and between Biolase Technology, Inc. and Henry Schein, Inc.
10.3	Forbearance Agreement, dated August 16, 2010, by and among Biolase Technology, Inc., MidCap Financial LLC, and Silicon Valley Bank.
10.4	Separation Agreement, dated August 24, 2010, by and between Biolase Technology, Inc. and David M. Mulder.
10.5	Distribution and Supply Agreement, dated September 23, 2010, by and between Biolase Technology, Inc. and Henry Schein, Inc.
10.6	Amended and Restated Security Agreement, dated September 23, 2010, by and between Biolase Technology, Inc. and Henry Schein, Inc.
10.7	Waiver and Amendment No. 1 to Loan and Security Agreement, dated September 23, 2010, by and among Biolase Technology, Inc., MidCap Funding III, LLC, and Silicon Valley Bank.
10.8	Amendment No. 1 to Warrant, dated September 23, 2010, in favor of MidCap Financial, LLC.
10.9	Amendment No. 1 to Warrant, dated September 23, 2010, in favor of SVB Financial Group.
31.1	Certification of Federico Pignatelli pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.
32.1	Certification of Federico Pignatelli pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Confidential treatment was requested for certain confidential portions of this exhibit pursuant to Rule 24b-2 under the Securities Exchange Act of 1934, as amended. In

accordance with
Rule 24b-2,
these
confidential
portions were
omitted from
this exhibit and
filed separately
with the
Securities and
Exchange
Commission.

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SIGNATURE

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

Dated: November 3, 2010

BIOLASE TECHNOLOGY, INC.,
a Delaware corporation

By: /s/ FEDERICO PIGNATELLI
Federico Pignatelli
Chairman and Chief Executive Officer
(Principal Executive Officer and
Principal Financial and Accounting
Officer)