SOLTA MEDICAL INC
Form 10-Q
November 03, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2010

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

For the transition period from _____ to _____

Commission File Number: 001-33123

SOLTA MEDICAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**68-0373593**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

25881 Industrial Boulevard, Hayward, California 94545

(Address of principal executive offices) (Zip Code)

(510) 782-2286

(Registrant s telephone number, including area code)

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

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

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

Large accelerated Filer ¨	Accelerated filer ¨
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of October 29, 2010, 59,572,792 shares of the registrant s common stock were outstanding.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (unaudited)

Solta Medical, Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands of dollars, except share and per share data)

(Unaudited)

	September 30, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 35,211	$ 14,744
Accounts receivable	10,484	12,381
Inventories	11,431	14,117
Prepaid expenses and other current assets	4,431	4,748
Total current assets	61,557	45,990
Property and equipment, net	6,421	5,613
Purchased intangible assets, net	36,965	36,799
Goodwill	48,710	47,289
Other assets	157	458
Total assets	$ 153,810	$ 136,149
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Accounts payable	$ 5,113	$ 6,065
Accrued liabilities	10,007	10,968
Current portion of deferred revenue	3,985	4,534
Short-term borrowings	9,504	9,432
Customer deposits	438	529
Total current liabilities	29,047	31,528
Deferred revenue, net of current portion	686	612
Term loan, net of current portion	489	1,626
Non-current tax liabilities	1,955	1,862
Other liabilities	197	284
Total liabilities	32,374	35,912
Contingencies (Note 8)		
Stockholders equity:		
Preferred stock, $0.001 par value:		
10,000,000 shares authorized, none issued and outstanding		

Common stock, $0.001 par value:		
100,000,000 shares authorized, 59,526,752 and 48,077,028 shares at September 30, 2010 and December 31, 2009, respectively.	60	48
Additional paid-in capital	192,300	169,283
Accumulated deficit	(70,924)	(69,094)
Total stockholders equity	121,436	100,237
Total liabilities and stockholders equity	$ 153,810	$ 136,149

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

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Solta Medical, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands of dollars, except share and per share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net revenue	$ 24,851	$ 17,753	$ 80,866	$ 70,415
Cost of revenue	9,110	7,311	29,610	29,595
Gross margin	15,741	10,442	51,256	40,820
Operating expenses				
Sales and marketing	10,170	8,958	31,487	28,471
Research and development	4,135	4,239	12,530	12,104
General and administrative	3,290	3,793	11,002	11,563
Litigation settlement gain			(2,213)	
Total operating expenses	17,595	16,990	52,806	52,138
Loss from operations	(1,854)	(6,548)	(1,550)	(11,318)
Interest and other income	502	195	266	432
Interest and other expenses	(62)	(136)	(243)	(287)
Gain on investments		159		224
Loss before income taxes	(1,414)	(6,330)	(1,527)	(10,949)
Provision (benefit) for income taxes	(8)	(84)	303	(13)
Net loss	$ (1,406)	$ (6,246)	$ (1,830)	$ (10,936)
Net loss per share:				
Basic	$ (0.02)	$ (0.13)	$ (0.03)	$ (0.23)
Diluted	$ (0.02)	$ (0.13)	$ (0.03)	$ (0.23)
Weighted average shares outstanding used in calculating net loss per common share:				
Basic	59,519,116	47,855,428	58,663,816	47,807,180
Diluted	59,519,116	47,855,428	58,663,816	47,807,180

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

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Solta Medical, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of dollars)

(Unaudited)

	Nine Months Ended September 30,	
	2010	2009
Cash flows from operating activities		
Net loss	$ (1,830)	$ (10,936)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,679	5,196
Amortization of premium on marketable investments		106
Realized gain on marketable investments		(227)
Loss on disposal of property, plant and equipment	46	15
Stock-based compensation	1,923	2,476
Tax expense from stock option exercises	8	
Provision for doubtful accounts	306	99
Provision for excess and obsolete inventory	623	515
Change in assets and liabilities:		
Accounts receivable	2,382	(4,080)
Inventories	2,283	4,114
Prepaid expenses and other current assets	402	847
Other assets	336	(18)
Accounts payable	(1,525)	(1,906)
Accrued and other liabilities	(2,892)	992
Accrued restructuring	(7)	(3,391)
Deferred revenue	(777)	632
Customer deposits	(91)	
Deferred rent	(53)	245
Net cash provided by (used in) operating activities	6,813	(5,321)
Cash flows from investing activities		
Acquisition of property and equipment	(1,365)	(1,486)
Payments for acquisition, net of cash acquired	(232)	(1,139)
Sales and maturities of marketable investments		17,990
Net cash provided by (used in) investing activities	(1,597)	15,365
Cash flows from financing activities		
Repayment of equipment leases	(29)	(5)
Repayment of loan agreement and short-term margin account borrowings	(25,067)	(21,966)
Cash settlement of vested restricted stock units	(140)	
Proceeds from exercise of stock options	461	26
Proceeds from employee stock purchase plan	231	93
Proceeds from loan agreement borrowings	24,000	18,975
Proceeds from equity financing	17,230	
Payment of equity financing issuance costs	(1,435)	

Net cash provided by (used in) by financing activities	15,251	(2,877)
Net increase in cash and cash equivalents	20,467	7,167
Cash and cash equivalents at beginning of period	14,744	7,556
Cash and cash equivalents at end of period	$ 35,211	$ 14,723
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 156	$ 221
Cash paid for taxes	116	367
Supplemental disclosure of non-cash investing and financing activities		
Issuance of common stock for acquisition	4,750	
Issuance of warrants in connection with equity financing	5,251	
Accounts payable and accrued liabilities related to property and equipment purchases	241	230
Contingent consideration accrued in connection with Aesthera acquisition	96	
Issuance of common stock for vested restricted stock units	359	

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

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Solta Medical, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

(Unaudited)

NOTE 1 THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Solta Medical, Inc. (the Company) develops, manufactures, and markets aesthetic energy devices to address a range of skin issues brought on by the effects of aging, environmental factors or hormonal changes. The Company was incorporated in California on January 11, 1996 as Thermage, Inc. and reincorporated in Delaware on September 10, 2001. The Company commercially launched its first products in October 2002. Following the acquisition of Reliant Technologies, Inc. (Reliant) on December 23, 2008, the Company changed its name to Solta Medical, Inc.

Basis of Presentation

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to state fairly the Company s financial position as of the date of the interim balance sheet and results of operations and cash flows for the interim periods. The results for the three and nine months ended September 30, 2010 are not necessarily indicative of the results to be expected for the year ending December 31, 2010 or for any other interim period or for any future year.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes for the year ended December 31, 2009 included in the Company s Annual Report on Form10-K.

Liquidity

In the year ended December 31, 2009, the Company incurred net cash outflows from operations. The Company entered into a term loan and revolving loan agreement in March 2009, which was subsequently amended later in the same month, in June 2009, in March 2010, and in October 2010 (see note 14). The agreement contains certain financial and non-financial covenants. The Company s future liquidity requirements may increase beyond currently expected levels if it fails to maintain compliance with such covenants, if revenue does not reach current expected results, if it fails to achieve sustained profitability or if unanticipated expenses or other uses of its cash arise. In order to meet its liquidity needs, the Company may be required to seek additional equity and/or debt financing. Additional financing may not be available on a timely basis or on terms acceptable to the Company. If adequate funds are not available, the Company may have to delay development of new products or reduce marketing, customer support or other resources devoted to its products. Any of these factors could harm the Company s business and financial condition.

In January 2010, the Company entered into securities purchase agreements in connection with a private placement of its securities to certain institutional and other accredited investors pursuant to which the Company agreed to sell and issue (i) an aggregate of 8,529,704 newly issued shares of its common stock, par value $0.001 per share and (ii) warrants to purchase an aggregate of 4,264,852 shares of common stock. This sale of securities resulted in aggregate gross proceeds of approximately $17,230. The net proceeds, after deducting offering expenses were approximately $15,795 (see note 9).

Significant Accounting Policies

The Company s significant accounting policies are disclosed in the Company s Annual Report on Form 10-K filed on March 22, 2010, and have not changed since December 31, 2009.

Segment Information

The Company operates in one business segment, which encompasses the developing, manufacturing and marketing of aesthetic energy devices. Management uses one measurement of profitability and does not segregate its business for internal reporting. All long-lived assets are

maintained in the United States. The Chief Operating Decision Maker is the Chairman, President and Chief Executive Officer of the Company.

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Solta Medical, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

The following table summarizes net revenue by product:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Systems	$ 9,294	$ 5,987	$ 32,424	$ 28,390
Tips and other consumables	13,425	9,552	41,968	35,000
Net revenue from products	22,719	15,539	74,392	63,390
Services and other	2,132	2,214	6,474	7,025
Total net revenue	$ 24,851	$ 17,753	$ 80,866	$ 70,415

The following table summarizes net revenue by geographic region:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
North America	$ 10,972	8,387	$ 36,935	33,122
Asia Pacific	7,895	4,384	25,151	16,185
Europe/Middle East	4,764	3,873	15,315	17,619
Rest of the world	1,220	1,109	3,465	3,489
Total net revenue	$ 24,851	$ 17,753	$ 80,866	$ 70,415

NOTE 2 NET LOSS PER COMMON SHARE

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

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

Historical net loss per share:	Three Months Ended September 30, 2010	2009	Nine Months Ended September 30, 2010	2009
Numerator:				
Net loss	$ (1,406)	$ (6,246)	$ (1,830)	$ (10,936)
Denominator:				
Weighted-average common shares outstanding	59,519,116	47,855,428	58,663,816	47,807,180
Basic and diluted net loss per share	$ (0.02)	$ (0.13)	$ (0.03)	$ (0.23)

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

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Solta Medical, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Options to purchase common stock	7,714,310	6,734,368	7,714,310	6,734,368
Common stock warrants	4,581,179	344,105	4,581,179	344,105
Restricted stock units	875,150		875,150	
Common stock issuable under Employee Stock Purchase Plan	106,663	153,371	106,663	153,371

NOTE 3 RECENT ACCOUNTING PRONOUNCEMENTS

In October 2009, the FASB issued Accounting Standards Update (ASU), 2009-13, *Revenue Recognition* (Topic 605): Multiple Deliverable Revenue Arrangements A Consensus of the FASB Emerging Issues Task Force. This update provides application guidance on whether multiple deliverables exist, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. This update establishes a selling price hierarchy for determining the deemed selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence, if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific or third-party evidence is available. The Company will be required to apply this guidance prospectively for revenue arrangements entered into or materially modified on or after January 1, 2011; however, earlier application is permitted. The Company has not yet adopted this standard and has not determined the impact that this update may have on its financial statements.

In January 2010, the FASB issued ASU, 2010-06, *Fair Value Measurement and Disclosures* (Topic 820), which relates to the disclosure requirements for fair value measurements and provides clarification for existing disclosures requirements. More specifically, this update will require (a) an entity to disclose separately the amounts of significant transfers in and out of Levels 1 and 2 fair value measurements and to describe the reasons for the transfers; and (b) information about purchases, sales, issuances and settlements to be presented separately (i.e. present the activity on a gross basis rather than net) in the reconciliation for fair value measurements using significant unobservable inputs (Level 3 inputs). This guidance clarifies existing disclosure requirements for the level of disaggregation used for classes of assets and liabilities measured at fair value and requires disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements using Level 2 and Level 3 inputs. The new disclosures and clarifications of existing disclosure are effective for fiscal years beginning after December 15, 2009, except for the disclosure requirements related to purchases, sales, issuances and settlements in the rollforward activity of Level 3 fair value measurements. The Company s adoption of ASU 2010-06 on January 1, 2010 did not have a material impact on the Company s financial position, results of operations or cash flows.

NOTE 4 ACQUISITION OF AESTHERA CORPORATION

On February 26, 2010, the Company acquired 100% of the common stock of Aesthera Corporation (Aesthera), a privately held company for consideration including $501 in cash and $4,750 of shares of the Company s common stock. The number of shares of the Company s common stock issued of 2,435,897 was determined based on the volume-weighted average closing market price of $1.95 per share of the Company s common stock during the five trading days preceding the acquisition date.

In connection with this transaction, the Company entered into a contingent consideration arrangement which may require payments ranging from $0 to $10,750 in shares of the Company s common stock if certain revenue milestones are achieved related to the sale of Aesthera products and if certain acquired Aesthera receivables are collected. The fair value of the contingent consideration recognized on the acquisition date of $280 was estimated by applying a probability weighted discounted cash-flow approach.

The measurement of the contingent consideration is based on significant inputs not observable in the market, which Topic 820 refers to as Level 3 inputs. Key assumptions include (i) a discount rate of 4.05% percent and (ii) probability of milestone achievement ranging from 0%-50%.

As of September 30, 2010 the fair value of the contingent consideration has been reduced to $96 to reflect the Company s updated assessment of the probabilities assigned to achieving the revenue milestones and accordingly a $61 and $184 gain was recognized in general and administrative expense in the Company s condensed consolidated statement of operations during the three and nine months ended September 30, 2010, respectively.

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Solta Medical, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

As a result of the acquisition, the Company has expanded its product offerings by providing treatment of acne to its customers through the Company s direct sales and distribution network worldwide.

During the three and nine months ended September 30, 2010, the Company incurred $15 and $979 of acquisition-related costs, respectively. These expenses are included in general and administrative expenses in the Company s condensed consolidated statement of operations for the three and nine months ended September 30, 2010.

The Company s condensed consolidated financial statements include the results of operations of Aesthera from the date of acquisition through September 30, 2010.

The following summarizes the preliminary purchase price allocation of the Aesthera acquisition:

Cash	$ 269
Accounts receivable	791
Inventory	1,613
Prepaid expenses and other assets	85
Property and equipment	108
Intangible assets:	
Isolaz trade name	300
Customer relationships	1,300
Core technology	2,100
Goodwill	1,421
Other long term assets	35
Total assets acquired	8,022
Liabilities assumed:	
Accounts payable	422
Accrued liabilities	1,525
Deferred revenue	302
Other liabilities	242
Total liabilities acquired	2,491
Net acquired assets	$ 5,531

Of the total original purchase price of $5,531, $3,700 was allocated to amortizable intangible assets, which are being amortized using a straight-line method over their respective estimated useful lives of five to six years. The valuation of identified intangible assets acquired was based on management s estimates, currently available information and reasonable and supportable assumptions. The allocation was based on the fair value of these assets determined using the income approach. The income approach uses a discounted cash flow model. The Company calculated the present value of the expected future cash flows attributable to the acquired intangibles using an 18% to 19% discount rate. With respect to intangible assets, there are several methods available under the income approach to quantify fair value. The Company used the following methods to quantify fair value of the acquired intangibles at the acquisition date. The excess earnings method was used for product

technology and customer relationships. The relief from royalties method was used for the trade name intangibles with a royalty rate of 1%.

The Company allocated the residual value of $1,421 to goodwill. Goodwill arising from the acquisition is attributable to the workforce of the acquired business and the significant synergies expected to arise. Goodwill is not expected to be deductible for tax purposes.

For the three months ended September 30, 2010 and for the period from February 26 to September 30, 2010, revenue from the sales of Aesthera products was $1,378 and $3,523, respectively. Net income associated with Aesthera products and operations cannot be determined given the integration of Aesthera operations within the Company.

Reliable information to provide pro forma financial disclosure on the Aesthera acquisition is currently unavailable and impracticable to prepare at this time. Therefore, such pro forma financial information has not been included herein.

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Solta Medical, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

NOTE 5 BALANCE SHEET DETAIL

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less at the time of purchase to be cash equivalents.

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

The Company s cash equivalents are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices for identical assets that the Company has the ability to assess at the measurement date. The Company s cash equivalents, which are money market funds that mature in three months or less, are classified as such at September 30, 2010 and December 31, 2009.

Fair Value of Financial Instruments

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

Inventories, Net

Inventories, net consist of the following:

	September 30, 2010	December 31, 2009
Raw materials	$ 4,120	$ 4,705
Work-in-process	$ 373	556
Finished goods	$ 6,938	8,856
	$ 11,431	$ 14,117

Intangible Assets

The carrying amount and accumulated amortization expense of the acquired intangible assets at September 30, 2010 and December 31, 2009 are as follows:

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Solta Medical, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

September 30, 2010	Estimated Useful Life	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Intangible assets amortized to cost of revenue:				
Core technology	6 -12 years	$ 20,520	($ 2,924)	$ 17,596
Product technology	7 years	9,270	(2,347)	6,923
Future royalties contract	10 years	3,890		3,890
		33,680	(5,271)	28,409
Intangible assets amortized to operating expenses:				
Product development contract	1.9 years	620	(586)	34
Non-compete agreement	2 years	500	(443)	57
Trade Names	6 -10 years	3,880	(663)	3,217
Customer relationships	5 -12 years	6,110	(862)	5,248
		11,110	(2,554)	8,556
Total intangible assets		$ 44,790	($ 7,825)	$ 36,965

December 31, 2009	Estimated Useful Life	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Intangible assets amortized to cost of revenue:				
Core technology	12 years	$ 18,420	($ 1,569)	$ 16,851
Product technology	7 years	9,270	(1,353)	7,917
Future royalties contract	10 years	3,890		3,890
		31,580	(2,922)	28,658
Intangible assets amortized to operating expenses:				
Product development contract	1.9 years	620	(338)	282
Non-compete agreement	2 years	500	(255)	245
Fraxel trade name	10 years	3,580	(366)	3,214
Customer relationships	12 years	4,810	(410)	4,400
		9,510	(1,369)	8,141
Total intangible assets		$ 41,090	($ 4,291)	$ 36,799

The Company has included amortization of acquired intangible assets directly attributable to revenue-generating activities in cost of revenue. The Company has included amortization of acquired intangible assets not directly related to revenue-generating activities in operating expenses. During the three and nine months ended September 30, 2010, the Company recorded amortization expense in the amount of $802 and $2,348 to cost of revenue, respectively, and $413 and $1,186 to operating expenses, respectively, and during the three and nine months ended September 30, 2009, the Company recorded amortization expense in the amount of $715 and $2,144 to cost of revenue, respectively, and $335

and $1,006 to operating expenses, respectively

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

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Solta Medical, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

As of September 30, 2010, the total expected future amortization related to intangible assets, is as follows:

	Amortization included in Cost of Revenue	Amortization included in Operating Expense	Total Amortization Expense
2010	$ 802	$ 375	$ 1,177
2011	3,209	1,069	4,278
2012	3,209	1,069	4,278
2013	3,209	1,069	4,278
2014	3,209	1,069	4,278
2015 and thereafter	14,771	3,905	18,676
	$ 28,409	$ 8,556	$ 36,965

Goodwill

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

	September 30, 2010	December 31, 2009
Balance at beginning of period	$ 47,289	48,158
Addition from acquisition	1,421	
Valuation adjustments		375
Settlement from escrow account		(1,244)
Balance at end of period	$ 48,710	$ 47,289

Accrued Liabilities

Accrued liabilities consist of the following:

	September 30, 2010	December 31, 2009
Payroll and related expenses	$ 3,680	$ 3,794
Royalties payable	278	1,277

Warranty	1,368	1,163
Professional fees	655	939
Accrued purchases	172	674
Other	3,854	3,121
	$ 10,007	$ 10,968

NOTE 6 WARRANTY AND SERVICE CONTRACTS

Standard Warranty

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

	Nine Months Ended September 30,	
	2010	**2009**
Balance at beginning of period	$ 1,163	$ 1,217
Additions from acquisition	240	
Accruals for warranties issued during the period	1,929	919
Settlements made during the period	(1,964)	(1,164)
Balance at end of period	$ 1,368	$ 972

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Solta Medical, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

Extended Warranty Contract

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

	Nine Months Ended September 30,	
	2010	2009
Balance at beginning of period	$ 2,440	$ 2,603
Additions from acquisition	302	
Payments received	2,591	2,462
Revenue recognized	(2,986)	(2,487)
Balance at end of period	$ 2,347	$ 2,578

As of September 30, 2010, $1,660 of the extended warranty contracts was classified as current and $686 was classified as non-current. The Company incurred costs of $189 and $675 under extended warranty contracts during the three and nine months ended September 30, 2010, respectively, and costs of $200 and $503 during the three and nine months ended September 30, 2009, respectively.

NOTE 7 CREDIT FACILITY

The Company entered into a Loan and Security Agreement (the Loan Agreement) with Silicon Valley Bank (the Lender) on March 9, 2009 with a subsequent amendment on March 27, 2009, providing for a $6,000 secured revolving loan facility, with availability to be subject to a borrowing base formula, and a $3,000 secured term loan. On June 30, 2009, the Company entered into a second amendment to the Loan Agreement which provides for an increase of the secured revolving loan facility to $8,000 and an additional $1,000 secured term loan. On March 31, 2010, the Company entered into a third amendment to the Loan Agreement which provides for an increase of the commitment under the loan facility by adding a $10 million secured term loan facility, amended the financial covenants, which includes changes to the liquidity ratio, minimum EBITDA covenant and removal of the tangible net worth covenant, and extended the maturity date of the existing revolving loan facility from March 9, 2011 to March 8, 2012. On October 15, 2010, the Company entered into a fourth amendment to the Loan Agreement (see note 14). At September 30, 2010, $8,000 was outstanding on the revolving loan facility and $1,993 was outstanding on the secured term loan.

Borrowings under the original revolving loan facility accrue interest at a per annum rate equal to the Lender s prime rate as in effect from time to time plus 1.00%, subject to a minimum per annum rate of 5.00%. Interest on borrowings under the revolving loan facility is payable monthly. The Company may borrow, repay and reborrow funds under the revolving loan facility until March 8, 2012, at which time it matures and all outstanding amounts under this facility must be repaid. In the event the Company elects to terminate the revolving loan facility on or before the maturity date, the Company is required to pay a fee in the amount of $60.

Borrowings under the secured term loan facility accrue interest at a per annum rate equal or greater of (i) 4.44% or (ii) the three-year U.S. treasury note yield on the funding date plus 3.00%. Term loans under such facility may be borrowed until March 31, 2011 and such loans must be repaid in 33 equal monthly payments of principal and interest, but no later than December 31, 2013. The Company may prepay all but not

less than all amounts loaned under such facility and in connection with such prepayment, the Company is required to pay a fee equal to 2.00% of the principal amount prepaid. On the earlier of the maturity date or the date the term loan facility is prepaid, the Company is required to make a final payment equal to 3.5% of the aggregate principal amount of all loans made under such facility.

All obligations under the Loan Agreement are secured by substantially all of the personal property of the Company.

In connection with the Loan Agreement, the Company s subsidiary, Reliant Technologies, LLC (Reliant LLC), entered into an Unconditional Guaranty, dated as of March 9, 2009 (the Guaranty), in favor of Lender, pursuant to which Reliant LLC guaranteed all of the obligations of the Company under the Loan Agreement, and a Security Agreement, dated as of March 9, 2009, with Lender, pursuant to which Reliant LLC granted a security interest in substantially all of its personal property to collateralize its obligations under the Guaranty.

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Solta Medical, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

The Loan Agreement contains restrictions that include, among others, restrictions that limit the Company s and its subsidiaries ability to dispose of assets, enter into mergers or acquisitions, incur indebtedness, incur liens, pay dividends or make distributions on the Company s capital stock, make investments or loans, and enter into certain affiliate transactions, in each case subject to customary exceptions for a credit facility of this size and type. As of September 30, 2010, the Loan Agreement contains financial covenants requiring the Company to maintain a minimum liquidity ratio and minimum EBITDA. The Company was in compliance with these covenants as of September 30, 2010. The Company repaid all funds drawn from the revolving loan facility in October 2010.

NOTE 8 CONTINGENCIES

Litigation Matters

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

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

On December 4, 2009, Aesthera was served with a class action complaint filed in the United States District Court for the District of Connecticut alleging that Aesthera caused unsolicited fax advertisements to be sent to the plaintiffs in violation of the Telephone Consumer Protection Act, or TCPA, and Connecticut state law. The complaint purports to be filed on behalf of a class, and it alleges that Aesthera caused unsolicited fax advertisements to be sent from August 1, 2006 through the present. Plaintiffs seek statutory damages under the TCPA and Connecticut state law, attorneys fees and costs of the action, and an injunction to prevent any future violations. In May 2010, the Company reached an agreement in principle to settle the matter by consenting to certification of a settlement class to receive payment out of a settlement fund. The Court stayed discovery until November 1, 2010 so that preliminary agreement of a class settlement could be submitted and a fairness hearing held to determine whether final approval of the settlement would be appropriate. The Company anticipates that the motion to certify a class for settlement purposes will be filed in early November, and that a fairness hearing will be held in the first quarter of 2011. If the process does not result in approval of a settlement, then we anticipate that the parties will engage in discovery and that Aesthera will vigorously oppose certification of a class. We do not believe the final disposition of this action will have a material adverse effect on our financial statements and future cash flows. We believe that we have meritorious defenses in this action and intend to defend the action vigorously if the proposed

settlement is not approved by the Court.

In January 2008, a product design complaint was filed against the Company in Federal District Court in Maryland. The plaintiff seeks monetary damages, a portion of which we believe are within our insurance limits, as well as attorney s fees and costs of the action. Discovery in the matter is essentially complete and the parties are awaiting the trial court s setting of a trial date, which we expect to be in the fall of 2011. We do not believe the final disposition of this action will have a material adverse effect on our operating results, financial condition or future cash flows. We believe that we have meritorious defenses in this action and intend to continue to defend the action vigorously.

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Solta Medical, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

Indemnifications

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

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

NOTE 9 STOCKHOLDERS EQUITY

On January 7, 2010, the Company entered into securities purchase agreements in connection with a private placement of its securities to certain institutional and other accredited investors pursuant to which the Company agreed to sell and issue (i) an aggregate of 8,529,704 newly issued shares of its common stock and (ii) warrants to purchase an aggregate of 4,264,852 shares of common stock. This sale of securities resulted in aggregate gross proceeds of approximately $17,230. The net proceeds, after deducting offering expenses, were approximately $15,795.

The common stock and warrants were sold in units consisting of one share of common stock and a warrant to purchase one-half of a share of common stock for an aggregate purchase price of $2.02 per unit which was equal to the closing price of the Company s common stock on the NASDAQ Global Market on January 6, 2010. The warrants have an exercise price of $2.121 per share, which represents a 5% premium over the closing price of the Company s common stock on the NASDAQ Global Market on January 6, 2010. The holders have the right to net exercise any outstanding warrants for shares of the Company's common stock. The warrants are exercisable commencing on the six-month anniversary of the closing of the sale of securities and will expire five and a half years from the date of issuance.

The fair value of the warrants at the issuance date was estimated using the Black-Scholes model using the following assumptions: dividend yield of 0%, risk-free interest rate of 2.57%, expected volatility of 65.5%, and contractual life of 5.5 years. The estimated fair value of the warrants was $5,251 on the date of issuance and was recorded as additional paid-in capital within stockholder s equity.

NOTE 10 COMPREHENSIVE LOSS

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net loss	$ (1,406)	$ (6,246)	$ (1,830)	$ (10,936)

Unrealized gain on marketable investments, net of tax				
Comprehensive loss	$ (1,406)	$ (6,246)	$ (1,830)	$ (10,936)

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Solta Medical, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

NOTE 11 STOCK-BASED COMPENSATION

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

	Three Months ended September 30,		Nine Months ended September 30,	
	2010	2009	2010	2009
Stock-based compensation expense:				
Employee stock-based compensation expense	$ 550	$ 732	$ 1,680	$ 2,211
Employee stock purchase plan	37	34	147	93
Restricted stock units	16	57	96	172
Total stock-based compensation expense	$ 603	$ 823	$ 1,923	$ 2,476

	Three Months ended September 30,		Nine Months ended September 30,	
	2010	2009	2010	2009
Cost of revenue	$ 66	$ 61	$ 208	$ 175
Sales and marketing	168	316	566	993
Research and development	91	85	222	192
General and administrative	278	361	927	1,116
Total stock-based compensation expense	$ 603	$ 823	$ 1,923	$ 2,476

During the nine months ended September 30, 2010 and 2009, under the 2006 Equity Incentive Plan, the board of directors approved the issuance of 918,950 and 0 shares of restricted stock units to certain employees, respectively. The value of the restricted stock awards was based on the closing stock market price on the award date. Out of the total restricted stock units granted in the first nine months of 2010, 731,000 of the awards vest over three years if certain corporate performance-based milestones are achieved, and as of March 31, 2010, the Company believed that it was probable that these performance milestones were achievable. However, as of September 30, 2010 and further review by management of these milestones, the Company determined that it was not probable that these performance milestones are achievable. As a result, stock based compensation expense was not recognized for these awards in the quarters ended June 30, 2010 and September 30, 2010 and the stock based compensation previously recognized of $44 for these awards during the quarter ended March 31, 2010 was reversed during the quarter ended June 30, 2010. The remaining 187,950 restricted stock units granted in the first quarter of 2010 vest over three years.

In addition, the Company also awarded 7,500 shares of restricted stock units to a non-employee during the nine months ended September 30, 2010. No restricted stock units were awarded in the first six months of 2009 to non-employees. The value attributable to these units was amortized on a straight line basis over the three month service period and the unvested portion of these units were revalued on June 15, 2010 based on the closing stock market price on June 15, 2010. The Company believes that the fair value of the units is more reliably measurable than

the fair value of the services received.

NOTE 12 LICENSE AGREEMENT

Through the acquisition of Reliant in December 2008, the Company has an exclusive, royalty bearing, worldwide license, with the right to sub-license, with Massachusetts General Hospital (MGH) to patent applications relating to some of the technology used in the Fraxel laser systems. This license, ongoing royalty obligations and all rights thereunder will terminate on December 31, 2010, provided however that MGH has granted a non-assert provision that applies to all of our products in the professional marketplace.

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NOTE 13 LITIGATION SETTLEMENT GAIN

The Company advised Alma Lasers, Ltd. and Alma Lasers, Inc. (together Alma) in February 2006 that Alma s Accent product infringed numerous patents owned by the Company. On April 26, 2007, Alma filed a lawsuit against the Company in the United States District Court for the District of Delaware requesting declaratory judgment that Alma s Accent product does not infringe the Company s patents and that the Company s patents are invalid. On June 20, 2007, the Company filed patent infringement counterclaims against Alma in the United States District Court for the District of Delaware asserting that Alma s Accent and Harmony systems infringe ten of the Company s U.S. patents. The counterclaims were amended on December 10, 2007 to include a claim of infringement of an eleventh patent. In addition to damages and attorney fees, the Company asked the Court to enjoin Alma from further infringement. During May, June and July 2008, Alma filed with the United States Patent and Trademark Office requests that all of the eleven patents asserted by the Company be reexamined. The United States Patent and Trademark Office has made rejections of some claims in each of these 11 patents. Some of the patents in reexamination have been reaffirmed, while others remain under rejection. As a result of a settlement reached on May 10, 2010, the Company and Alma granted each other a covenant not to sue under the patents asserted in the lawsuit and related patents. In addition, Alma paid the Company a non-returnable one-time amount of $2,250 in connection with this settlement. External legal fees incurred during the three and nine months ended September 30, 2010 in connection with the settlement amounted to $0 and $37, respectively. In connection with this settlement, the Company has recorded a net gain of $0 and $2,213 in operating expenses during the three and nine months ended September 30, 2010, respectively.

NOTE 14 SUBSEQUENT EVENTS

Credit Facility Amendment

On October 15, 2010, the Company entered into the Fourth Amendment to its Loan Agreement. The Fourth Amendment authorized the Company to consummate the Merger (as defined below) with CLRS Technology Corporation (CLRS), a private company. Other terms of the Loan Agreement remain unchanged.

Acquisition of CLRS

On October 15, 2010, pursuant to the terms of the Agreement and Plan of Merger dated as of October 15, 2010, by and among the Company, Solta Temp, Inc., a wholly owned subsidiary of the Company (Merger Sub), CLRS and Richard Clement, as Representative, Merger Sub was merged with and into CLRS and, as a result, CLRS continues as a surviving corporation and is a wholly owned subsidiary of the Company (the Merger). The Company acquired all outstanding shares of capital stock of CLRS for an aggregate merger consideration consisting of the payment of approximately $1,100 of debt at the closing of the Merger and potential future payments based on CLRS revenue and operating income through the end of 2011.

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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws. These statements include, but are not limited to, introduction of new procedures and associated treatment tips in the future; sales organization growth; growth in international sales and expansion into new international markets; and our belief that our cash, cash equivalents and marketable investments, along with our credit facility will satisfy our anticipated cash requirements. These statements are subject to risks and uncertainties that could cause actual results and events to differ materially from those expressed or implied by such forward-looking statements. For a detailed discussion of these risks and uncertainties, see Risk Factors section in Item 1A of this Quarterly Report on Form 10-Q. We caution the reader not to place undue reliance on these forward-looking statements, which reflect management s analysis only as of the date of this Form 10-Q. We undertake no obligation to update forward-looking statements, which reflect events or circumstances occurring after the date of this Form 10-Q. We also encourage you to read the Critical Accounting Policies in Item 7 Management s Discussion and Analysis contained in Part II of our Annual Report on Form 10-K filed on March 22, 2010.

Overview

We design, develop, manufacture and market aesthetic energy devices to address a range of skin issues brought on by the effects of aging, environmental factors or hormonal changes. We were incorporated in 1996 and received FDA clearance for treatment of periorbital wrinkles and commercially launched our first Thermage system in 2002. In June 2004, we received FDA clearance for the treatment of facial wrinkles and rhytides. In December 2005, we received FDA clearance to market our system for the treatment of wrinkles and rhytides, without limitation to particular areas of the body. In October 2006, we received FDA clearance to market our system for the temporary improvement in the appearance of cellulite. In June 2007, we received clearance to market our system for treatment of wrinkles and rhytides for the upper and lower eyelids. In June 2009, we received FDA clearance to market our latest Thermage system and hand piece configuration for wrinkles, rhytides and for the temporary improvement in the appearance of cellulite. Our patented and FDA-cleared systems use radiofrequency, or RF, energy to heat and shrink collagen and tighten tissue while simultaneously cooling and protecting the surface of the skin.

Laser devices used for aesthetic procedures, such as skin resurfacing, are generally regulated as Class II medical devices, requiring 510(k) clearance. The FDA has granted fourteen 510(k) clearances for four Fraxel devices relating to multiple indications for use. We received FDA clearance to market our first generation Fraxel SR750 system for coagulation of soft tissue in November 2003 and subsequently for treatment of periorbital wrinkles (June 2004), pigmented lesions (June 2004), melasma (July 2005), skin resurfacing procedures (July 2005) and acne and surgical scars (March 2006). In March 2006, we received FDA clearance to market our Fraxel re:store system for soft tissue coagulation and for treatment of periorbital wrinkles, pigmented lesions, melasma and skin resurfacing. We subsequently received FDA clearance for the Fraxel re:store for treatment of acne and surgical scars in January 2007 and for actinic keratoses in May 2007. In April 2007, we received FDA clearance to market the Fraxel re:fine system for soft tissue

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coagulation and for treatment of periorbital wrinkles, pigmented lesions, skin resurfacing, acne scars and surgical scars. The Fraxel re:pair system was cleared for ablation, coagulation and resurfacing of soft tissue in April 2007 and for treatment of wrinkles, pigmentation, textural irregularities and vascular dyschromia in November 2007. We received FDA clearance for two additional Fraxel re:pair hand pieces in July 2008, which deliver ablative and incisional treatments for surgical applications. In October 2009, we received FDA clearance to market the Fraxel DUAL system, which consists of 1550nm and 1927nm wavelength lasers.

The acquisition of Aesthera Corporation (Aesthera) has added intense pulsed light, which we sometimes refer to as IPL , devices to our product portfolio. In April 2005, Aesthera received FDA clearance to market its first IPL system for the treatment of benign vascular and pigmented lesions, and permanent hair reduction. In September 2006, the Aesthera PPx System received FDA clearance for the treatment of benign vascular and pigmented lesions, permanent hair reduction, and the additional indication of treatment of mild to moderate acne. The Isolaz system received FDA clearance in January 2009 for the treatment of benign vascular and pigmented lesions, permanent hair reduction, and mild to moderate acne.

As of September 30, 2010, we had a global installed base of over 6,800 systems.

Net revenue for the nine months ended September 30, 2010 increased 15% or $10.5 million, to $80.9 million, from $70.4 million in the same period in 2009, mainly from higher tip revenue, an increase in upgrade and net system sales and the contributions from Aesthera products under the Isolaz brand name. Our business continued to be impacted by the weakness in global economic conditions and tightening of the credit markets, which resulted in a slowdown in customer purchase decisions. As our procedures are generally elective, the slowing economy reduced demand for our procedures. The tight credit markets limited the ability of some of our customers to obtain financing for the purchase of our products. In response to the continuing difficulties in the economy, we have implemented a number of initiatives in response to the tight worldwide credit market, including expanding our partner program to include Fraxel consumables as well as offering incentives to doctors who become Fraxel, Thermage and Isolaz customers.

Acquisition of Aesthera Corporation

On February 26, 2010, we acquired 100% of the common stock of Aesthera Corporation, a privately held company for consideration including $0.5 million in cash and $4.8 million of shares of our common stock. The number of shares of our common stock issued of 2,435,897 was determined based on the volume-weighted average closing market price of $1.95 per share during the five trading days preceding the acquisition date.

In connection with this transaction, we entered into a contingent consideration arrangement which may require payments ranging from $0 to $10.75 million in shares of our common stock if certain revenue milestones are achieved related to the sale of Aesthera products and if certain acquired Aesthera receivables are collected. The fair value of the contingent consideration recognized on the acquisition date of $0.3 million was estimated by applying a probability weighted discounted cash-flow approach.

The measurement of the contingent consideration is based on significant inputs not observable in the market, which Topic 820 refers to as Level 3 inputs. Key assumptions include (i) a discount rate of 4.05% percent and (ii) probability of milestone achievement ranging from 0%-50%.

As of September 30, 2010 the fair value of the contingent consideration has been reduced to $96,000 to reflect our updated assessment of the probabilities assigned to achieving the revenue milestones and accordingly a $61,000 and $184,000 gain was recognized in general and administrative expense in our condensed consolidated statement of operations during the three and nine months ended September 30, 2010, respectively.

As a result of the acquisition, we have expanded our product offerings by providing treatment of acne to its customers through our direct sales and distribution network worldwide.

During the three and nine months ended September 30, 2010, we incurred $15,000 and $1.0 million of acquisition-related costs, respectively. These expenses are included in general and administrative expenses in our condensed consolidated statement of operations for the three and nine months ended September 30, 2010.

Our condensed consolidated financial statements include the results of operations of Aesthera from the date of acquisition through September 30, 2010.

Of the total original purchase price of $5.5 million, $3.7 million was allocated to amortizable intangible assets, which are being amortized using a straight-line method over their respective estimated useful lives of five to six years. The valuation of identified intangible assets acquired was

based on management s estimates, currently available information and reasonable and supportable assumptions. The allocation was based on the fair value of these assets determined using the income approach. The income approach

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uses a discounted cash flow model. We calculated the present value of the expected future cash flows attributable to the acquired intangibles using an 18% to 19% discount rate. With respect to intangible assets, there are several methods available under the income approach to quantify fair value. We used the following methods to quantify fair value of the acquired intangibles at the acquisition date. The excess earnings method was used for product technology and customer relationships. The relief from royalties method was used for the trade name intangibles with a royalty rate of 1%.

We allocated the residual value of $1.4 million to goodwill at February 26, 2010. Goodwill arising from the acquisition is attributable to the workforce of the acquired business and the significant synergies expected to arise after. Goodwill is not expected to be deductible for tax purposes.

Significant Business Trends

We derive revenue primarily from the sale of systems, treatment tips and consumables. For the years ended December 31, 2009 and 2008, and the nine months ended September 30, 2010 and 2009, we derived 48%, 73%, 52% and 50% respectively, of our revenue from treatment tips and consumable sales, and 43%, 24%, 40% and 40% respectively, of our revenue from system sales. The balance of our revenue is derived from service, research and development and shipping. In the third quarter of 2009, we launched two new systems, the Thermage CPT and Fraxel re:store Dual.

With the acquisition of Reliant Technologies, Inc. (Reliant) and Aesthera, we have seen sales of treatment tips and consumables increase as a percentage of our revenue versus system sales, and revenue derived from sales of products and services within North America decreased as a percentage of our total revenue.

We market our products in North America to physicians, primarily dermatologists and plastic surgeons, through a direct sales force and internationally through a network of independent distributors and our direct sales force in certain countries. In the years ended December 31, 2009 and 2008, and the nine months ended September 30, 2010 and 2009, we derived 46%, 52%, 46% and 47%, respectively, of our revenue from sales of our products and services within North America, and 54%, 48%, 54% and 53%, respectively, of our total sales outside of North America. We believe that a significant portion of our business will continue to come from international sales through increased penetration in countries where we currently sell our products, combined with expansion into new international markets. The percentages of our revenue by region are presented in the table below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
North America	44%	47%	46%	47%
Asia Pacific	32%	25%	31%	23%
Europe/Middle East	19%	22%	19%	25%
Rest of the world	5%	6%	4%	5%
Total net revenue	100%	100%	100%	100%

We continue to believe our bifurcated sales force will serve us well. With the acquisition of Reliant and Aesthera, we have one of the largest North American direct sales forces in the industry, with about half of the sales force focusing on existing customers and sales of treatment tips, upgrades and training, and the remainder focusing on securing new accounts.

Future operating results are difficult to predict accurately. We anticipate that our quarterly results of operations may fluctuate for the foreseeable future due to several factors, including prevailing economic conditions and our customers access to credit, the timing of introduction and the degree of acceptance of future product offerings, unanticipated interruptions and expenses related to our manufacturing operations, and the performance of our direct sales force and international distributors. The tight credit markets limited the ability of some of our customers to obtain financing for the purchase of our products. We have implemented a number of initiatives in response to the tight worldwide credit market, including expanding our partner program to include Fraxel consumables as well as offering incentives to doctors who become Fraxel, Thermage and Isolaz customers.

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

delivered to meet customer demand.

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Significant Industry Factors

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

Results of Operations

Three and Nine Months Ended September 30, 2010 and 2009

Net Revenue. Revenue is derived from the sales of systems, treatment tips and other consumables, and service and other revenue. Net revenue was $24.9 million for the three months ended September 30, 2010, an increase of $7.1 million, or 40%, compared to $17.8 million for the three months ended September 30, 2009. This increase in net revenue is primarily due to increased system sales, an increase in tip revenue, an increase in upgrade sales, and the contributions from Isolaz products and services of $1.4 million, partially offset by a decline in handpiece sales. In addition, revenue in the third quarter of 2009 was low due to a slowdown of customer purchasing decisions, production delays and ongoing regulatory review process during the quarter. System sales for the three months ended September 30, 2010 was $9.3 million, an increase of $3.3 million, or 55%, compared to $6.0 million for the same period in 2009. Sales of treatment tips and other consumables was $13.4 million, an increase of $3.8 million, or 40%, compared to $9.6 million for the same period in 2009.

Net revenue increased $10.5 million, or 15%, to $80.9 million from $70.4 million for the nine months ended September 30, 2010 and 2009, respectively. This increase was primarily due to the contributions from the sales of Isolaz products and services of $3.5 million, an increase in tips and consumable sales and an increase in system sales and system upgrades, partially offset by a decline in other revenue and handpiece sales. System sales increased $4.0 million or 14%, to $32.4 million from $28.4 million for the nine months ended September 30, 2010 and 2009, respectively. Sales of treatment tips and other consumables increased $6.9 million, or 20%, to $41.9 million from $35.0 million for the nine months ended September 30, 2010 and 2009, respectively.

Cost of Revenue. Our cost of revenue consists primarily of material, labor and manufacturing overhead expenses. Gross margin was 63% of revenue for the three months ended September 30, 2010, compared with 59% of revenue for the same period in 2009. The increase in gross margin as a percent of revenue for the third quarter of 2010 when compared to the prior year period was primarily due to lower manufacturing period costs as a percentage of higher sales volume, partially offset by an increase in amortization expense from intangibles acquired in the Aesthera Acquisition.

Gross margin was 63% of revenue in the first nine months of 2010, compared with 58% of revenue in the first nine months of 2009. The increase in gross margin as a percent of revenue for the first nine months of 2010 when compared to the prior year period was primarily due to a higher proportion of higher-margin tip sales, a resolution of a previously entered into technology license agreement, and a decrease in purchase price related adjustment to cost of sales that resulted from the acquisition of Reliant in December 2008, partially offset by a higher proportion of lower margin system upgrade sales.

Sales and Marketing. Sales and marketing expenses consist primarily of personnel costs and costs related to customer-attended workshops and trade shows and advertising, as well as marketing and customer service expenses. Sales and marketing expenses for the three months ended September 30, 2010 was $10.2 million, an increase of $1.2 million, or 14%, compared to $9.0 million for the same period in 2009. The increase was primarily attributable to an increase of $0.6 million in headcount and related personnel and travel and entertainment expenses, an increase of $0.4 million in discretionary marketing expenses, an increase of $0.1 million in professional outside services, and an increase of $0.1 million of amortization of intangibles acquired in the Aesthera acquisition.

Sales and marketing expenses increased $3.0 million, or 11%, to $31.5 million from $28.5 million in the first nine months of 2010 and 2009, respectively. The increase in the first nine months of 2010 was primarily attributable to an increase in headcount and related personnel and travel and entertainment expense of $2.1 million, an increase in professional services of $0.3 million, an increase of $0.4 million in discretionary

marketing spending, and an increase of $0.2 million of amortization of intangibles acquired in the Aesthera acquisition.

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Research and Development. Research and development expenses consist primarily of personnel costs, clinical and regulatory costs, material costs and regulatory and quality assurance costs not directly related to the manufacturing of our products. Research and development expenses for the three months ended September 30, 2010 was $4.1 million, a decrease of $0.1 million, or 3%, compared to $4.2 million for the same period in 2009. The decrease was mainly due to a decrease of $0.2 million in discretionary spending, a decrease of $0.2 million in headcount and related personnel expenses, partially offset by an increase of $0.3 million in professional services.

Research and development increased $0.4 million, or 4% to $12.5 million from $12.1 million in the first nine months of 2010 and 2009, respectively. Compared to the first nine months of 2009, professional services increased by $1.0 million and employee payroll and related expenses increased by $0.1 million, partially offset by a decrease of $0.5 million in clinical studies and other R&D project costs, and a decrease of $0.2 million in telecommunication, depreciation and allocated information technology and facility expenses.

General and Administrative. General and administrative expenses consist primarily of personnel costs, legal and accounting fees, human resources costs and other general operating expenses. General and administrative expenses for the three months ended September 30, 2010 was $3.3 million, a decrease of $0.5 million, or 13%, compared with $3.8 million for the same period in 2009. The decrease from the same period in the prior year was primarily due to a decrease of $0.2 million in professional services, a decrease of $0.2 million in bad debt expense, a decrease of $0.1 million in product liability and a decrease of $0.1 million in business insurance, partially offset by an increase of $0.1 million in telecommunication, depreciation and allocated information technology and facility expenses.

General and administrative expenses for the nine months ended September 30, 2010 was $11.0 million, a decrease of $0.6 million or 5%, compared with $11.6 million in the first nine months of 2009. The decrease from the prior year period was due to a decrease of $1.1 million in professional services, primarily due to a decrease in outside accounting and legal fees, a decrease of $0.2 million in sales and use taxes, a decrease of $0.3 million in business insurance and a decrease of $0.2 million in product liability, partially offset by an increase of $0.2 million in employee payroll and related expenses and an increase of $1.0 million in acquisition related expense resulting from the acquisition of Aesthera.

Litigation Settlement. In May 2010, we reached an agreement with Alma Lasers, Ltd. and Lama Lasers, Inc. (together Alma) that settled patent-related claims of the parties against each other. Under this agreement, the parties granted each other a covenant not to sue under the patents in the suit and related patents. We received a one-time payment of $2.3 million and incurred external legal expenses of $37,000 for the nine months ended September 30, 2010. This resulted in a net litigation settlement gain of $2.21 million in our statement of operations for the nine months ended September 30, 2010.

Interest and Other Income. Interest and other income consist primarily of interest income generated from our cash, cash equivalents and marketable investments. Interest and other income increased $0.3 million, or 157%, to $0.5 million for the three months ended September 30, 2010 from $0.2 million for the same period in 2009. The increase is primarily due to increased foreign exchange gains during the third quarter of 2010 due to currency fluctuations, partially offset by lower interest income from lower average investment balances since all the Company s marketable securities matured in 2009. Interest and other income were $0.3 million and $0.4 million for the first nine months of 2010 and 2009, respectively.

Interest and Other Expenses. Interest and other expense consist primarily of interest expense resulting from borrowings on the margin account, line of credit and term loans. Interest and other expenses were $0.1 million and $0.1 million in the three months ended September 30, 2010 and 2009, respectively, and were $0.2 million and $0.3 million in the first nine months of 2010 and 2009, respectively.

Provision for Income Taxes. There was an income tax benefit of $8,000 and $84,000 for the three months ended September 30, 2010 and 2009, respectively, and $13,000 for the nine months ended September 30, 2009. There was an income tax provision of $0.3 million for the nine months ended September 30, 2010. The provision for income taxes for the nine months ended September 30, 2010 primarily represented additions to AMT taxes and additions to reserves for uncertain tax positions. We did not recognize any tax benefits in relation to the loss before income taxes for the nine months ended September 30, 2010 as we maintained a full valuation allowance for deferred taxes.

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Stock-Based Compensation

For the three and nine months ended September 30, 2010 and 2009, employee and non-employee stock-based compensation expense has been allocated as follows (in thousands):

	Three Months ended September 30,		Nine Months ended September 30,	
	2010	2009	2010	2009
Cost of revenue	$ 66	$ 61	$ 208	$ 175
Sales and marketing	168	316	566	993
Research and development	91	85	222	192
General and administrative	278	361	927	1,116
Total stock-based compensation expense	$ 603	$ 823	$ 1,923	$ 2,476

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Reconciliation of GAAP to Non-GAAP Financial Measures

The following presentation includes non-GAAP measures. Our non-GAAP measures are not meant to be considered in isolation or as a substitute for comparable GAAP measures. For a detailed explanation of the adjustments made to comparable GAAP measures, the reasons why management uses these measures, the usefulness of these matters and the material limitation of these measures, see items (1) (5) below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
GAAP Gross margin	$ 15,741	$ 10,442	$ 51,256	$ 40,820
Non-GAAP adjustments to gross margin:				
Amortization and other non-cash acquisition related charges (1)	940	895	2,942	4,919
Stock-based compensation (4)	66	61	208	175
Non-GAAP gross margin	$ 16,747	$ 11,398	$ 54,406	$ 45,914
Non-GAAP gross margin as % of sales	67%	64%	67%	65%
GAAP loss from operations	($ 1,854)	($ 6,548)	($ 1,550)	($ 11,318)
Non-GAAP adjustments to net loss from operations:				
Amortization and other non-cash acquisition related charges (1)	1,291	1,229	3,942	5,904
Severance expenses (2)			55	118
Acquisition-related expenses (3)	15		978	
Stock-based compensation (4)	603	823	1,923	2,476
Non-GAAP income (loss) from operations	$ 55	($ 4,496)	$ 5,348	($ 2,820)
Depreciation expenses (5)	747	650	2,145	2,045
Non-GAAP adjusted EBITDA	$ 802	($ 3,846)	$ 7,493	($ 775)
GAAP net loss	($ 1,406)	($ 6,246)	($ 1,830)	($ 10,936)
Non-GAAP adjustments to net income (loss):				
Amortization and other non-cash acquisition related charges (1)	1,291	1,229	3,942	5,904
Severance expenses (2)			55	118
Acquisition-related expenses (3)	15		978	
Stock-based compensation (4)	603	823	1,923	2,476
Non-GAAP net income (loss)	$ 503	($ 4,194)	$ 5,068	($ 2,438)
GAAP basic net loss per share	($ 0.02)	($ 0.13)	($ 0.03)	($ 0.23)
Non-GAAP adjustments to basic loss per share:				
Amortization and other non-cash acquisition related charges (1)	$ 0.02	$ 0.03	$ 0.07	$ 0.12
Severance expenses (2)	$ 0.00		$ 0.00	$ 0.00
Acquisition-related expenses (3)	$ 0.00		$ 0.02	
Stock-based compensation (4)	$ 0.01	$ 0.02	$ 0.03	$ 0.06
Non-GAAP basic net income (loss) per share	$ 0.01	($ 0.09)	$ 0.09	($ 0.05)
Non-GAAP diluted net income (loss) per share	$ 0.01	($ 0.09)	$ 0.08	($ 0.05)
GAAP weighted average shares outstanding used in calculating basic net loss per share	59,519,116	47,855,428	58,663,816	47,807,180
	59,519,116	47,855,428	58,663,816	47,807,180

GAAP weighted average shares outstanding used in calculating diluted net loss per share				
Adjustments for dilutive potential common stock	1,701,112		1,926,538	
Weighted average shares outstanding used in calculating non-GAAP diluted net income (loss) per share	61,220,228	47,855,428	60,590,354	47,807,180

The Non-GAAP financial measures are non-GAAP gross margin, non-GAAP gross margin as a % of sales, non-GAAP operating income, non-GAAP adjusted EBITDA, non-GAAP net income and non-GAAP net income per share, which adjust for the following items: amortization of acquired intangibles and other non-cash acquisition-related charges, severance expenses, acquisition-related expenses and stock-based compensation expense. We believe that the presentation of these non-GAAP financial measures is useful for investors, and as such measures are used by our management, for the reasons associated with each of the adjusting items as described below:

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

(2) *Severance expenses* include acquisition related severance expenses and are disregarded by our management when evaluating and predicting earnings trends because these charges are unique to specific acquisitions, and are therefore excluded by us when presenting non-GAAP financial measures.

(3) *Acquisition-related costs* include direct costs of the acquisition and expenses related to acquisition integration activities. Examples of costs directly related to an acquisition include transaction fees, due diligence costs and certain legal costs related to acquired litigation. These expenses vary significantly in size and amount and are disregarded by our management when evaluating and predicting earnings trends because these charges are unique to specific acquisitions, and are therefore excluded by us when presenting non-GAAP financial measures.

(4) *Stock-based compensation expense* consist of expense relating to stock-based awards issued to employees, outside directors and non employees including stock options, restricted stock units, restricted stock units with performance-based vesting and our Employee Stock Purchase Plan. Because of varying available valuation methodologies, subjective assumptions and the variety of award types, we believe that the exclusion of stock-based compensation expense allows for more accurate comparisons of our operating results to our peer companies, and for a more accurate comparison of our financial results to previous periods. In addition, we believe it is useful to investors to understand the specific impact of stock-based compensation expenses on our operating results.

(5) *Depreciation expense* includes depreciation and amortization of leasehold improvements, furniture and fixtures, machinery and equipment, software and computers and equipment. Our management excludes this charge from operating income (loss) to compute non-GAAP earnings before income taxes, depreciation and amortization.

Liquidity and Capital Resources

On September 30, 2010, we had working capital of $32.5 million, which included $35.2 million of cash and cash equivalents.

In January 2010, we entered into securities purchase agreements in connection with a private placement of our securities to certain institutional and other accredited investors pursuant to which we agreed to sell and issue (i) an aggregate of 8,529,704 newly issued shares of our common stock, and (ii) warrants to purchase an aggregate of 4,264,852 shares of our common stock. The sale of securities resulted in aggregate gross proceeds of approximately $17.2 million. The net proceeds, after deducting offering expenses were approximately $15.8 million.

In March 2009, we entered into a Loan and Security Agreement (the Loan Agreement) with Silicon Valley Bank (Lender) for a $6.0 million secured revolving loan facility and a $3.0 million secured term loan. We drew down $3.8 million on the revolving loan facility and $3.0 million as a term loan in March 2009, and repaid the revolving loan in full in April 2009. On June 30, 2009, we entered into an amendment to the Loan Agreement which provides for an increase of the secured revolving loan facility to $8.0 million and an additional $1.0 million secured term loan. On March 31, 2010, we entered into a third amendment to the Loan Agreement which provides for an increase of the commitment under the loan facility by adding a $10.0 million secured term loan facility, amended certain financial covenants and extended the term of the existing revolving loan facility. On October 15, 2010, we entered into a fourth amendment to the Loan Agreement, which authorized us to consummate the acquisition of CLRS Technology Corporation on October 15, 2010. Borrowings under the original revolving loan facility accrue interest at prime plus 1.00% per annum, subject to a minimum of 5.00% per annum. Borrowings under the secured term loan facility accrue interest at a per annum rate equal or greater of (i) 4.44% or (ii) the three-year U.S. treasury note yield on the funding date plus 3.00. Interest on borrowings under the revolving loan facility is payable monthly. The secured term loans are payable in 33 equal monthly payments of principal and interest. The Loan Agreement contains certain financial covenants requiring us to maintain a minimum liquidity ratio and minimum EBITDA. We were in compliance with these covenants as of September 30, 2010. At September 30, 2010, $8.0 million was outstanding on the revolving loan facility and $2.0 million was outstanding on the secured term loan. We repaid all funds drawn from the revolving loan facility in October 2010.

In connection with the Loan and Security Agreement, our subsidiary, Reliant Technologies, LLC (Reliant LLC), entered into an Unconditional Guaranty, dated as of March 9, 2009 (the Guaranty), in favor of Lender, pursuant to which Reliant LLC guaranteed all of our obligations under the Loan Agreement, and a Security Agreement, dated as of March 9, 2009, with Lender, pursuant to which Reliant LLC granted a security interest in substantially all of its personal property to collateralize its obligations under the Guaranty.

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

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

We believe that our current cash and cash equivalent balances and cash generated from operations, along with the credit facilities, will meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months. Our future liquidity requirements may increase beyond currently expected levels if we fail to maintain compliance with covenants in our bank loan agreements or if unanticipated expenses or other uses of our cash arise. In order to meet our future liquidity needs, we may seek additional equity and/or debt financing. Such additional financing may not be available on a timely basis on terms acceptable to us, or at all, particularly in the short-term due to the current credit and equity market funding environments. Any future equity financing would result in dilution to our stockholders. The availability of financing or merger opportunities will depend, in part, on market conditions, and the outlook for our company.

Net Cash Provided by (Used in) Operating Activities. Net cash provided from operating activities was $6.8 million for the nine months ended September 30, 2010 compared to net cash of $5.3 million used in operating activities for the same period in 2009. During the first nine months of 2010, cash was provided by a decrease of $2.4 million in accounts receivable, a $2.3 million decrease in inventory, a $0.4 million decrease in prepaid expenses and other current assets and $6.8 million net cash provided from net loss after adjusting for non-cash items. These were partially offset by a $2.9 million decrease in accrued and other liabilities, a $1.5 million decrease in accounts payable, and a $0.8 million decrease in deferred revenue.

During the nine months ended September 30, 2009, cash was used to fund an increase of $4.1 million in accounts receivable that was primarily due to a high percentage of sales late in the period, a decrease of $3.4 million in accrued restructuring liabilities and a $1.9 million decrease in accounts payable. These were partially offset by $4.1 million of cash provided by a decrease in inventory, a $1.0 million increase in accrued and other liabilities, $0.9 million decrease in prepaid expenses and other current assets and $2.8 million net cash provided from net loss after adjusting for non-cash items. The decrease in inventory during the first nine months of 2010 and 2009 was primarily due to sales during the period supplemented by tighter management of inventory purchases.

Net Cash Provided by (Used in) Investing Activities. Net cash used in investing activities was $1.6 million for the nine months ended September 30, 2010 compared with $15.4 million cash provided by investing activities during the same period in 2009. During the first nine months of 2010, net cash of $1.4 million was used for payments to acquire property and equipment and $0.2 million was used for the acquisition of Aesthera Corporation, net of cash received. During the first nine months of 2009, net cash of $18.0 million was provided by the sale or maturities of our marketable investments in the first nine months of 2009, partially offset by $1.1 million of payments of transaction costs, net of escrow settlement relating to the Reliant acquisition and $1.5 million of payments for acquisitions of property and equipment.

Net Cash Provided by (Used in) Financing Activities. Net cash provided by financing activities was $15.3 million for the nine months ended September 30, 2010 compared with $2.9 million of net cash used in financing activities in the same period in 2009. During the first nine months of 2010, we completed a private placement offering which resulted in net proceeds of $15.8 million in cash and we also received $0.5 million in proceeds from exercise of stock options, offset by net payments of $1.1 million on our term and revolving loans and $0.1million to settle tax obligations on behalf of our employees for the issuance of restricted stock units. During the first nine months of 2009, we made net borrowings of $9.4 million in term loans and under the line of credit from Silicon Valley Bank, and repaid $12.4 million on the margin account maintained with JP Morgan Chase related to our marketable investments.

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

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Recent Accounting Pronouncements

In October 2009, the FASB issued Accounting Standards Update (ASU), 2009-13, *Revenue Recognition* (Topic 605): Multiple Deliverable Revenue Arrangements A Consensus of the FASB Emerging Issues Task Force. This update provides application guidance on whether multiple deliverables exist, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. This update establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence, if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific or third-party evidence is available. We will be required to apply this guidance prospectively for revenue arrangements entered into or materially modified after January 1, 2011; however, earlier application is permitted and we have not yet adopted this standard and have not determined the impact that this update may have on its financial statements.

In January 2010, the FASB issued ASU, 2010-06, *Fair Value Measurement and Disclosures* (Topic 820), which relates to the disclosure requirements for fair value measurements and provides clarification for existing disclosures requirements. More specifically, this update will require (a) an entity to disclose separately the amounts of significant transfers in and out of Levels 1 and 2 fair value measurements and to describe the reasons for the transfers; and (b) information about purchases, sales, issuances and settlements to be presented separately (i.e. present the activity on a gross basis rather than net) in the reconciliation for fair value measurements using significant unobservable inputs (Level 3 inputs). This guidance clarifies existing disclosure requirements for the level of disaggregation used for classes of assets and liabilities measured at fair value and requires disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements using Level 2 and Level 3 inputs. The new disclosures and clarifications of existing disclosure are effective for fiscal years beginning after December 15, 2009, except for the disclosure requirements related to purchases, sales, issuances and settlements in the rollforward activity of Level 3 fair value measurements. Our adoption of Topic 820 on January 1, 2010 did not have a material impact on our financial position, results of operations or cash flows.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Risk

Currently, most of our sales and purchases are denominated in U.S. dollars, although, future fluctuations in the value of the U.S. dollar may affect the price competitiveness of our products. We do not believe, however, that we currently have significant direct foreign currency exchange rate risk and have not hedged exposures denominated in foreign currencies.

Interest Rate Risk

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

ITEM 4. CONTROLS AND PROCEDURES

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

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

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We advised Alma as early as February 2006 that its Accent product infringed numerous Thermage patents. On April 26, 2007, Alma filed a lawsuit against us in the United States District Court for the District of Delaware requesting declaratory judgment that Alma s Accent product does not infringe Thermage s patents and that Thermage s patents are invalid. On June 20, 2007, we filed patent infringement counterclaims against Alma in the United States District Court for the District of Delaware asserting that Alma s Accent and Harmony systems infringe ten of our U.S. patents. The counterclaims were amended on December 10, 2007 to include a claim of infringement of an eleventh patent. In addition to damages and attorney fees, we asked the Court to enjoin Alma from further infringement. During May, June and July 2008, Alma filed with the United States Patent and Trademark Office requests that all of the eleven patents asserted by us be reexamined. The United States Patent and Trademark Office has made rejections of some claims in each of these 11 patents. Some of the patents in reexamination have been reaffirmed, while others remain under rejection. As a result of a settlement reached on May 10, 2010, we and Alma granted each other a covenant not to sue under the patents asserted in the lawsuit and related patents In addition, Alma paid us a non-returnable one-time amount of $2.3 million in connection with this settlement. External legal fees incurred during the three and nine months ended September 30, 2010 in connection with the settlement amounted to $9,000 and $37,000, respectively. In connection with this settlement, we have recorded a net gain of $2.2 million in operating expenses during the three and nine months ended September 30, 2010.

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

On December 4, 2009, Aesthera was served with a class action complaint filed in the United States District Court for the District of Connecticut alleging that Aesthera caused unsolicited fax advertisements to be sent to the plaintiffs in violation of the Telephone Consumer Protection Act, or TCPA, and Connecticut state law. The complaint purports to be filed on behalf of a class, and it alleges that Aesthera caused unsolicited fax advertisements to be sent from August 1, 2006 through the present. Plaintiffs seek statutory damages under the TCPA and Connecticut state law, attorneys fees and costs of the action, and an injunction to prevent any future violations. In May 2010, the Company reached an agreement in principle to settle the matter by consenting to certification of a settlement class to receive payment out of a settlement fund. The Court stayed discovery until November 1, 2010 so that preliminary agreement of a class settlement could be submitted and a fairness hearing held to determine whether final approval of the settlement would be appropriate. The Company anticipates that the motion to certify a class for settlement purposes will be filed in early November, and that a fairness hearing will be held in the first quarter of 2011. If the process does not result in approval of a settlement, then we anticipate that the parties will engage in discovery and that Aesthera will vigorously oppose certification of a class. We do not believe the final disposition of this action will have a material adverse effect on our financial statements and future cash flows. We believe that we have meritorious defenses in this action and intend to defend the action vigorously if the proposed settlement is not approved by the Court.

In January 2008, a product design complaint was filed against the Company in Federal District Court in Maryland. The plaintiff seeks monetary damages, a portion of which we believe are within our insurance limits, as well as attorney s fees and costs of the action. Discovery in the matter is essentially complete and the parties are awaiting the trial court s setting of a trial date, which we expect to be in the fall of 2011. We do not believe the final disposition of this action will have a material adverse effect on our operating results, financial condition or future cash flows. We believe that we have meritorious defenses in this action and intend to continue to defend the action vigorously.

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In addition, from time to time, we are subject to legal proceedings and claims with respect to such matters as patents, intellectual property rights, product liability claims and contractual disputes with distributors, suppliers and others, arising out of the normal course of business. Litigating claims of these types, whether or not ultimately determined in our favor or settled by us, is costly and diverts the efforts of management and other personnel from normal business operations. The results of legal proceedings cannot be predicted with certainty. Should we fail to prevail in any of these legal matters or should several of these legal matters be resolved against us in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

ITEM 1A. RISK FACTORS

Risks Related to Our Business

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

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

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

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

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

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

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

- delays in receipt of anticipated purchase orders;
- seasonal variations in patient demand for aesthetic procedures;
- the impact of general economic conditions on the demand for aesthetic procedures;

performance of our independent distributors;

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

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

our ability to obtain further regulatory clearances or approvals;

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

changes in the length of the sales process;

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

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customer response to the introduction of new product offerings;

fluctuations in foreign currency; and

excess or obsolete inventory charges.

Our success depends on growing physician adoption of our Thermage, Fraxel and our recently acquired Isolaz systems and continued use of our treatment tips.

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

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

We incurred a loss of $11.2 million in the year ended December 31, 2009 and a loss of $1.8 million for the nine months ended September 30, 2010. In the past, we have expanded our business and increased our expenses in order to grow revenue. We will have to increase our revenue while effectively managing our expenses in order to achieve sustained profitability. Our failure to achieve or sustain profitability could negatively impact the market price of our common stock.

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

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

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

The failure of our systems to meet patient expectations or the occurrence of unpleasant side effects from the Thermage, Fraxel and Isolaz procedures could impair our financial performance.

Our future success depends upon patients having a positive experience with the Thermage, Fraxel and Isolaz procedures in order to increase physician demand for our products, as a result of both individual patients repeat business and as a result of word-of-mouth referrals. We believe that patients may be dissatisfied with the Thermage, Fraxel and Isolaz procedures if they find them to be too painful. Furthermore, patients may experience temporary swelling or reddening of the skin as a procedural side effect. In rare instances, patients may receive burns, blisters, skin discoloration or skin depressions. Experiencing excessive pain or any of these side effects or adverse events could discourage a patient from having a Thermage. Fraxel and Isolaz procedure or discourage a patient from having additional procedures or referring Thermage and Fraxel

procedures to others. In order to generate repeat and referral business, we also believe that patients must be satisfied with the effectiveness of the procedures. Results obtained from a Thermage, Fraxel and Isolaz procedure are subjective and may be subtle. A Thermage, Fraxel and Isolaz treatment may produce results that may not meet patients expectations. If patients are not satisfied with the procedure or feel that it is too expensive for the results obtained, our reputation and future sales will suffer.

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

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

We may face problems with our acquisition of Aesthera Corporation and CLRS Technology Corporation.

On February 26, 2010, we completed our acquisition of Aesthera Corporation, or Aesthera, a developer, manufacturer and marketer of light-based aesthetic treatment systems and on October 15, 2010 we completed our acquisition of CLRS Technology Corporation, or CLRS, a developer, manufacturer and marketer of a personal care light-based aesthetic system.

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

- the potential disruption of the combined company s ongoing business and diversion of management resources;
- the possibility that the business cultures are not compatible;
- the difficulty of incorporating acquired products, technology and rights into the combined company s products and services;
- unanticipated expenses related to integration of operations;
- the possibility that we are unsuccessful in marketing directly to consumers, which is the market targeted by CLRS;
- the impairment of relationships with employees and customers as a result of any integration of new personnel;
- potential unknown liabilities associated with the acquired business and technology;
- potential periodic impairment of goodwill and intangible assets acquired; and

potential inability to retain, integrate and motivate key personnel.

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

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

We may not be able to successfully integrate the combined business, products or technologies. In addition, the integration of such acquisition and management of any collaborative project may divert management s time and resources from our core business and disrupt our operations. If we decide to expand our product offerings, we may spend time and money on projects that do not increase our revenue. Any cash acquisition we pursue would diminish funds available to us for other uses, and any stock acquisition would dilute our stockholders ownership. While we from time to time evaluate potential collaborative projects and acquisitions of businesses, products and technologies, and anticipate continuing to make these evaluations, we have no present understandings, commitments or agreements with respect to any other acquisitions or collaborative projects.

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

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

- hire qualified individuals as needed;
- provide adequate training for the effective sale of our products; and
- retain and motivate our sales employees.

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

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

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

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

Litigation related to infringement and other intellectual property claims, with or without merit, is unpredictable, can be expensive and time-consuming and could divert management s attention from our core business. If we lose this kind of litigation, a court could require us to pay substantial damages, and prohibit us from using technologies essential to our products, any of which would have a material adverse effect on our business, results of operations and financial condition. We do not know whether necessary licenses would be available to us on satisfactory terms, or whether we could redesign our products or processes to avoid infringement.

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

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

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

On December 21, 2009, a complaint was filed in the Santa Clara County Superior Court by three former stockholders of Reliant Technologies, Inc. against Reliant and certain former officers and directors of Reliant in connection with our acquisition of Reliant, which closed on December 23, 2008. The complaint purports to be brought on behalf of the former common stockholders of Reliant. As a result of the acquisition, a successor entity to Reliant, Reliant Technologies, LLC, became our wholly-owned subsidiary. Eric Stang and Leonard DeBenedictis are among the defendants named in the complaint. Mr. Stang is a member of our board of directors, and Mr. DeBenedictis is a former member of our board of directors and our former Chief Technology Officer. The principal claim,

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among others, is that Reliant violated the California Corporations Code by failing to obtain the vote from a majority of holders of Reliant s common stock prior to the consummation of the acquisition. The complaint also purports to challenge disclosures made by Reliant in connection with its entry into the acquisition and that the defendants failed to maximize the value of Reliant for the benefits of Reliant s common stockholders. We believe that this suit is without merit, and we intend to vigorously defend it. Although we do not expect that the final disposition of this litigation will have a material adverse effect on our financial results, we may have to devote certain personnel and resources to resolve this litigation.

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

We rely on a combination of patent, copyright, trademark and trade secret laws and confidentiality and invention assignment agreements to protect our intellectual property rights. As of September 30, 2010, we had 82 issued U.S. patents, 70 pending U.S. patent applications, 55 issued foreign patents and 58 pending foreign patent applications, some of which foreign applications preserve an opportunity to pursue patent rights in multiple countries. Some of our system components are not, and in the future may not be, protected by patents. Additionally, our patent applications may not issue as patents or, if issued, may not issue in a form that will be advantageous to us. Any patents we obtain may be challenged, invalidated or legally circumvented by third parties. Consequently, competitors could market products and use manufacturing processes that are substantially similar to, or superior to, ours. We may not be able to prevent the unauthorized disclosure or use of our technical knowledge or other trade secrets by consultants, vendors, former employees or current employees, despite the existence generally of confidentiality agreements and other contractual restrictions. Monitoring unauthorized uses and disclosures of our intellectual property is difficult, and we do not know whether the steps we have taken to protect our intellectual property will be effective. Moreover, we do not have patent rights in all foreign countries in which a market may exist, and where we have applied for foreign patent rights, the laws of many foreign countries will not protect our intellectual property rights to the same extent as the laws of the United States.

In addition, competitors could purchase our systems and attempt to replicate some or all of the competitive advantages we derive from our development efforts, willfully infringe our intellectual property rights, design around our protected technology or develop their own competitive technologies that fall outside of our intellectual property rights. If our intellectual property is not adequately protected so as to protect our market against competitors products and methods, our competitive position could be adversely affected, as could our business.

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

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

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

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

International sales accounted for 54% of our revenue for the year ended December 31, 2009 and 48% of our revenue for each of the years ended December 31, 2008 and 2007. We believe that a significant portion of our business will continue to come from international sales through increased penetration in countries where we currently sell our products, combined with expansion into new international markets. However, international sales are subject to a number of risks, including:

difficulties in staffing and managing our international operations;

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- difficulties in penetrating markets in which our competitors products are more established;
- reduced or no protection for intellectual property rights in some countries;
- export restrictions, trade regulations and foreign tax laws;
- regulation of the sale of the hydroflurocarbon used with our ThermaCool system;
- fluctuating foreign currency exchange rates;
- foreign certification and regulatory clearance or approval requirements;
- difficulties in developing effective marketing campaigns for unfamiliar, foreign countries;
- dependence on third-party distributors in some territories;
- customs clearance and shipping delays;
- political and economic instability;
- preference for locally produced products;
- business interruption resulting from transitioning to direct sales from international distributors in certain international regions; and
- difficulties in getting distributors to relinquish regulatory documentation.

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

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

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

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

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

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

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

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Competition in the aesthetics market could result in price-cutting, reduced profit margins and loss of market share, any of which would harm our business, financial condition and results of operations. Our ability to compete effectively depends upon our ability to distinguish our company and our products from our competitors and their products, and on such factors as:

- safety and effectiveness;
- product pricing;
- success of our marketing initiatives;
- compelling clinical data;
- intellectual property protection;
- quality of customer support; and
- development of successful distribution channels, both domestically and internationally.

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

In addition, some of our current and potential competitors have significantly greater financial, research and development, manufacturing, and sales and marketing resources than we have. Our competitors could utilize their greater financial resources to acquire other companies to gain enhanced name recognition and market share, as well as new technologies or products that could effectively compete with our existing product line. Given the relatively few competitors currently in the market, any business combination could exacerbate any existing competitive pressures, which could harm our business.

Competition among providers of devices for the aesthetics market is characterized by rapid innovation, and we must continuously develop new products or our revenue may decline.

While we attempt to protect our products through patents and other intellectual property rights, there are few barriers to entry that would prevent new entrants or existing competitors from developing products that compete directly with ours. As we continue to create market demand for non-surgical, non-invasive or minimally invasive treatments, competitors will enter the market with other products making similar or superior claims. We expect that any competitive advantage we may enjoy from our current and future innovations may diminish over time, as companies successfully respond to our, or create their own, innovations. Consequently, we believe that we will have to continuously innovate and improve our products and technology to compete successfully. If we are unable to innovate successfully, our systems could become obsolete and our revenue will decline as our customers purchase competing products.

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

Negative publicity regarding our Thermage, Fraxel, Isolaz or future procedures could harm demand, which would adversely affect sales and our financial performance.

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

Our reputation and competitive position may be harmed not only by negative media exposure, but also by other publicly-available information suggesting that our procedures are not safe. For example, we file reports with the FDA that are publicly available on the FDA s website if our product may have caused or contributed to a serious injury or malfunctioned in a way that

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would likely cause or contribute to a serious injury if it were to recur. Competitors may attempt to harm our reputation by pointing to isolated injuries that have been reported or publicized, or by claiming that their product is superior because they have not filed as many reports with the FDA. Such negative publicity and competitor behavior could harm our reputation and our future sales.

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

Several components and materials that comprise our products are currently manufactured by a single supplier or a limited number of suppliers. In many of these cases, we have not yet qualified alternate suppliers and rely upon purchase orders, rather than long-term supply agreements. A supply interruption or an increase in demand beyond our current suppliers capabilities could harm our ability to manufacture our products until new sources of supply are identified and qualified. Our reliance on these suppliers subjects us to a number of risks that could harm our business, including:

- interruption of supply resulting from modifications to or discontinuation of a supplier s operations;
- delays in product shipments resulting from uncorrected defects, reliability issues or a supplier s variation in a component;
- a lack of long-term supply arrangements for key components with our suppliers;
- inability to obtain adequate supply in a timely manner, or to obtain adequate supply on commercially reasonable terms;
- difficulty locating and qualifying alternative suppliers for our components in a timely manner;
- production delays related to the evaluation and testing of products from alternative suppliers, and corresponding regulatory qualifications;
- delay in delivery due to our suppliers prioritizing other customer orders over ours;
- damage to our brand reputation caused by defective components produced by our suppliers;
- increased cost of our warranty program due to product repair or replacement based upon defects in components produced by our suppliers; and
- fluctuation in delivery by our suppliers due to changes in demand from us or their other customers.

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

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

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

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

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

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

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

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

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

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

Even though we require training for users of Thermage, Fraxel and Isolaz systems and do not sell our systems to non-physicians, there exists a potential for misuse, which could harm our reputation and our business.

While we only sell our products to licensed physicians who have met our training requirements, federal regulations allow us to sell our systems to licensed practitioners. The definition of licensed practitioners varies from state to state. As a result, our systems may be operated by licensed practitioners with varying levels of training, and in many states by non-physicians, including physician assistants, registered nurses and nurse practitioners. Thus, in some states, the definition of licensed practitioner may result in the legal use of our products by non-physicians. Outside the United States, our independent distributors sell in many jurisdictions that do not require specific qualifications or training for purchasers or operators of products. We do not supervise the procedures performed with our systems, nor can we be assured that direct physician supervision of our equipment occurs according to our recommendations. We, and our distributors, require purchasers of our products to undergo an initial training session as a condition of purchase, but do not require ongoing training. In addition, we prohibit the sale of our systems to companies that rent our systems to third parties without our approval, but cannot prevent an otherwise qualified physician from contracting with a rental company in violation of their purchase agreement with us. The use of our systems by non-physicians, as well as noncompliance with the operating guidelines set forth in our training programs, may result in product misuse and adverse treatment outcomes, which could harm our reputation and expose us to costly product liability litigation.

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

If our products are defectively designed, manufactured or labeled, contain defective components or are misused, we may become subject to substantial and costly litigation by our customers or their patients. For example, as described under Legal Proceedings, one such litigation matter is currently pending. Misusing our products or failing to adhere to operating guidelines could cause significant skin damage and underlying tissue damage. In addition, if our operating guidelines or product design are found to be inadequate, we may be subject to liability. We have been, continue to be and may, in the future, be involved in litigation related to the use of our products. Product liability claims could divert management s attention from our core business, be expensive to defend and result in sizable damage awards against us. We may not have sufficient insurance coverage for all future claims. We may not be able to obtain insurance in amounts or scope sufficient to provide us with adequate coverage against all potential liabilities. Any product liability claim brought against us, with or without merit, could increase our product liability insurance rates or prevent us from securing continuing coverage, could harm our reputation in the industry and reduce product sales. Product liability claims in excess of our insurance coverage would be paid out of cash reserves, harming our financial condition and reducing our operating results.

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

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

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

Our success largely depends on the skills, experience and efforts of our officers and other key employees. Many of our officers and key employees do not have employment contracts with us and can terminate their employment at any time. The loss of any of our senior management team members could weaken our management expertise and harm our business.

Our ability to retain our skilled labor force and our success in attracting and hiring new skilled employees will be a critical factor in determining whether we will be successful in the future. We may not be able to meet our future hiring needs or retain existing personnel. We will face particularly significant challenges and risks in hiring, training, managing and retaining engineering and sales and marketing employees, as well as independent distributors, most of whom are geographically dispersed and must be trained in the use and benefits of our products. Failure to attract and retain personnel, particularly technical and sales and marketing personnel, would materially harm our ability to compete effectively and grow our business.

Risks Related to Regulatory Matters

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

Our Thermage, Fraxel and our recently acquired Isolaz systems are medical devices that are subject to extensive regulation in the United States by the FDA for manufacturing, labeling, sale, promotion, distribution and shipping. Before a new medical device, or a new use of or claim for an existing product, can be marketed in the United States, it must first receive either 510(k) clearance or premarket approval from the FDA, unless an exemption applies. Either process can be expensive and lengthy. The FDA s 510(k) clearance process usually takes from three to 12 months, but it can take significantly longer. The process of obtaining premarket approval is much more costly and uncertain than the 510(k) clearance process, and it generally takes from one to three years, or even longer, from the time the application is filed with the FDA.

Medical devices may be marketed only for the indications for which they are approved or cleared. We have obtained 510(k) clearance for various indications for our Thermage and Fraxel systems. In addition, 510(k) clearance has been obtained for various indications of our recently acquired Isolaz systems. However, our clearances can be revoked if safety or effectiveness problems develop. We are also subject to Medical Device Reporting regulations, which require us to report to the FDA if our product causes or contributes to a death or serious injury, or malfunctions in a way that would likely cause or contribute to a death or serious injury if the malfunction were to recur. Our products are also subject to state regulations which are, in many instances, in flux. Changes in state regulations may impede sales. For example, federal regulations allow our systems to be sold to, or on the order of, licensed practitioners, as determined on a state-by-state basis. As a result, in some states, non-physicians may legally purchase and operate our systems. However, a state could change its regulations at any time, disallowing sales to particular types of end users. We cannot predict the impact or effect of future legislation or regulations at the federal or state levels.

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

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

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

operating restrictions or partial suspension or total shutdown of production;

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

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

criminal prosecution.

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

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

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

If we or our repair subcontractors fail to comply with the FDA s Quality System Regulation, our business would suffer.

We and our repair subcontractors are required to demonstrate and maintain compliance with the FDA s Quality System Regulation, or QSR. The QSR is a complex regulatory scheme that covers the methods and documentation of the design, testing, control, manufacturing, labeling, quality assurance, packaging, storage and shipping of our product. The FDA enforces the QSR through periodic unannounced inspections. We have been, and anticipate in the future being, subject to such inspections. Our failure, or the failure of our repair subcontractors, to take satisfactory corrective action in response to an adverse QSR inspection could result in enforcement actions, including a public warning letter, a shutdown of our manufacturing operations, a recall of our products, civil or criminal penalties or other sanctions, which would cause our sales and business to suffer.

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

Sales of our products outside the United States are subject to international regulatory requirements that vary widely from country to country. In addition, the FDA regulates exports of medical devices from the United States. Complying with international regulatory requirements can be an expensive and time-consuming process and approval is not certain. The time required to obtain licenses, registrations or approvals, if required by other countries, may be longer than that required for FDA clearance or approvals, and requirements for such licenses, registrations or approvals may significantly differ from FDA requirements. In markets where we sell through distributors, we primarily rely upon distributors to obtain all regulatory licenses, registrations and approvals required in countries outside of the United States, and these distributors may be unable to obtain or maintain such licenses, registrations and approvals. Our distributors may also incur significant costs in attempting to obtain and in maintaining regulatory licenses, registrations and approvals, which could increase the difficulty of attracting and retaining qualified distributors. If our distributors experience delays in receiving necessary licenses, registrations or approvals to market our products outside the United States, or if they fail to receive those licenses, registrations or approvals, we may be unable to market our products or enhancements in international markets effectively, or at all. To support the marketing of products outside the United States, we must comply with and be certified to the ISO 13485: 2003-2007 Quality System Standard. Failure to adequately maintain our ISO 13485: 2003-2007 certification may adversely impact or prevent the marketing of our products internationally.

Risks Related to Our Internal Control over Financial Reporting

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

Pursuant to the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated by the SEC, we are required to maintain disclosure controls and procedures and adequate internal control over financial reporting. Under such requirements we must furnish in our Form 10-K a report by our management regarding the effectiveness of our internal control over financial reporting. The report includes, among other things,

an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management. While we

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currently believe our internal control over financial reporting is effective, the effectiveness of our internal controls in future periods is subject to the risk that our controls may become inadequate because of changes in conditions. The effectiveness of our controls and procedures may in the future be limited by a variety of factors, including:

- faulty human judgment and simple errors, omissions or mistakes;
- fraudulent action of an individual or collusion of two or more people;
- inappropriate management override of procedures; and
- the possibility that any enhancements to controls and procedures may still not be adequate to assure timely and accurate financial information.

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

Risks Related to Our Common Stock

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

We provide guidance to the investing community regarding our anticipated future operating performance. Our business typically has a short sales cycle, so that we do not have significant backlog of orders at the start of a quarter, and our ability to sell our products successfully is subject to many uncertainties, as discussed in the foregoing risk factors. In light of these factors, and the uncertainty as a result of the general economic situation, it is difficult for us to estimate with accuracy our future results. Our expectations regarding these results will be subject to numerous risks and uncertainties that could make actual results differ materially from those anticipated. If our actual results do not meet our public guidance or our guidance or actual results do not meet the expectations of third-party financial analysts, our stock price could decline significantly.

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

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

- volume and timing of sales of our products;
- the introduction of new products or product enhancements by us or our competitors;
- disputes or other developments with respect to our intellectual property rights or the intellectual property rights of others;
- our ability to develop, obtain regulatory clearance or approval for and market new and enhanced products on a timely basis;
- product liability claims or other litigation;

quarterly variations in our or our competitors results of operations;

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

developments in our industry;

media exposure of our products or products of our competitors;

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

changes in earnings estimates or recommendations by securities analysts; and

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

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

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

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

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

Our officers, directors and principal stockholders each holding more than 5% of our common stock collectively control approximately 35% of our outstanding common stock. As a result, these stockholders, if they act together, will be able to significantly influence the management and affairs of our company and most matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. This concentration of ownership may have the effect of delaying or preventing a change in control and might adversely affect the market price of our common stock. This concentration of ownership may not be in the best interests of our other stockholders.

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

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

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

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

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

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

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

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

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

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. (REMOVED AND RESERVED)

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

Exhibit

No.	**Description**
10.1*	Amendment to Non-Competition and Non-Solicitation Agreement, Change of Control and Severance Agreement and Letter Agreement; Release of Claims, dated as of September 15, 2010 by and between Leonard C. DeBenedictis and the Company, and the Non-Competition and Non-Solicitation Agreement, dated as of July 6, 2008 by and between Leonard C. DeBenedictis and the Company.
31.1	Certification of Chief Executive Officer under Securities Exchange Act Rule 13a-14(a).
31.2	Certification of Chief Financial Officer under Securities Exchange Act Rule 13a-14(a).
32.1	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S. C. 1350 and Securities Exchange Act Rule 13a-14(b).

* Portions of this exhibit have been omitted pending a determination by the Securities and Exchange Commission as to whether these portions should be granted confidential treatment.

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SIGNATURES

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

SOLTA MEDICAL, INC.

Date: November 3, 2010

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

Date: November 3, 2010

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

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