BIOLASE TECHNOLOGY INC
Form 10-Q
November 10, 2011

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

FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2011
OR

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

BIOLASE TECHNOLOGY, INC.
(Exact name of registrant as specified in its charter)

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

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

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

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

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o	Smaller Reporting Company þ
		(Do not check if a 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 o No þ

The number of shares of the issuer s common stock, $0.001 par value per share, outstanding as of November 8, 2011 was 30,311,007 shares.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,757	$ 1,694
Accounts receivable, less allowance of $242 and $311 in 2011 and 2010, respectively	8,074	3,331
Inventory, net	9,823	6,987
Prepaid expenses and other current assets	1,199	1,355
Total current assets	24,853	13,367
Property, plant and equipment, net	1,168	1,331
Intangible assets, net	244	342
Goodwill	2,926	2,926
Deferred tax asset	13	11
Other assets	186	170
Total assets	$ 29,390	$ 18,147
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Term loan payable, current portion	$	$ 2,622
Accounts payable	5,859	4,029
Accrued liabilities	5,759	5,482
Customer deposits	180	5,877
Deferred revenue, current portion	1,905	1,650
Total current liabilities	13,703	19,660
Deferred tax liabilities	598	544
Warranty accrual, long-term	385	424
Deferred revenue, long-term	33	433
Other liabilities, long-term	387	133
Total liabilities	15,106	21,194
Stockholders equity (deficit):		
Preferred stock, par value $0.001, 1,000 shares authorized, no shares issued and outstanding		
Common stock, par value $0.001, 50,000 shares authorized; 32,264 and 27,424 shares issued and 30,300 and 25,460 shares outstanding in 2011	33	27

and 2010, respectively				
Additional paid-in capital		138,115		118,375
Accumulated other comprehensive loss		(283)		(324)
Accumulated deficit		(107,182)		(104,726)
		30,683		13,352
Treasury stock (cost of 1,964 shares repurchased)		(16,399)		(16,399)
Total stockholders equity (deficit)		14,284		(3,047)
Total liabilities and stockholders equity (deficit)	$	29,390	$	18,147

See accompanying notes to consolidated financial statements.

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

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Products and services revenue	$ 13,047	$ 6,002	$ 35,282	$ 15,085
License fees and royalty revenue	14	218	419	1,422
Net revenue	13,061	6,220	35,701	16,507
Cost of revenue	7,743	4,429	19,931	12,515
Gross profit	5,318	1,791	15,770	3,992
Operating expenses:				
Sales and marketing	3,217	2,110	8,680	7,825
General and administrative	1,987	1,330	5,913	5,031
Engineering and development	1,052	775	3,238	2,990
Total operating expenses	6,256	4,215	17,831	15,846
Loss from operations	(938)	(2,424)	(2,061)	(11,854)
Gain (loss) on foreign currency transactions	44	(118)	(10)	(75)
Interest income		1		2
Interest expense	(2)	(157)	(306)	(216)
Non-operating gain (loss), net	42	(274)	(316)	(289)
Loss before income tax provision	(896)	(2,698)	(2,377)	(12,143)
Income tax provision	57	28	79	52
Net loss	$ (953)	$ (2,726)	$ (2,456)	$ (12,195)
Net loss per share:				
Basic	$ (0.03)	$ (0.10)	$ (0.09)	$ (0.48)
Diluted	$ (0.03)	$ (0.10)	$ (0.09)	$ (0.48)
Shares used in the calculation of net loss per share:				
Basic	30,227	25,287	28,514	25,262
Diluted	30,227	25,287	28,514	25,262

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash Flows From Operating Activities:		
Net loss	$ (2,456)	$ (12,195)
Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	562	830
Loss on disposal of assets, net	8	3
Impairment of property, plant and equipment		35
Provision (recovery) for bad debts	27	(47)
Provision for inventory excess and obsolescence	118	
Amortization of discounts on term loan payable	78	17
Amortization of debt issuance costs	99	39
Stock-based compensation	1,000	499
Other equity instruments compensation	226	
Other non-cash compensation	187	24
Deferred income taxes	(2)	43
Changes in operating assets and liabilities:		
Accounts receivable	(4,770)	1,415
Inventory	(2,954)	(571)
Prepaid expenses and other assets	58	407
Customer deposits	(5,697)	8,418
Accounts payable and accrued liabilities	2,359	(1,206)
Deferred revenue	(145)	(1,278)
Net cash and cash equivalents used in operating activities	(11,302)	(3,567)
Cash Flows From Investing Activities:		
Additions to property, plant and equipment	(294)	(220)
Net cash and cash equivalents used in investing activities	(294)	(220)
Cash Flows From Financing Activities:		
Proceeds from term loan payable		3,000
Payments under term loan payable	(2,700)	
Payment of debt issuance costs		(85)
Proceeds from exercise of warrants	8	
Payment to repurchase equity warrants	(130)	
Proceeds from equity offering, net of expenses	17,237	
Proceeds from exercise of stock options	1,218	148
Net cash and cash equivalents provided by financing activities	15,633	3,063
Effect of exchange rate changes	26	(25)

Increase (decrease) in cash and cash equivalents		4,063		(749)
Cash and cash equivalents, beginning of year		1,694		2,975
Cash and cash equivalents, end of period	$	5,757	$	2,226
Supplemental cash flow disclosure:				
Cash paid during the period for:				
Interest	$	81	$	113
Income taxes	$	8	$	(95)

See accompanying notes to consolidated financial statements.

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

NOTE 1 BASIS OF PRESENTATION

The Company

BIOLASE Technology Inc. (the Company), incorporated in Delaware in 1987, is a medical technology company operating in one business segment that develops, manufactures and markets lasers, and markets and distributes dental imaging equipment and other products designed to improve technologies for applications and procedures in dentistry and medicine.

Basis of Presentation

The unaudited consolidated financial statements include the accounts of BIOLASE Technology, Inc. and its consolidated subsidiaries and have been prepared on a basis consistent with the December 31, 2010 audited consolidated financial statements and include all material adjustments, consisting of normal recurring adjustments and the elimination of all material intercompany transactions and balances, necessary to fairly present the information set forth therein. These unaudited, interim, consolidated financial statements do not include all the footnotes, presentations and disclosures normally required by accounting principles generally accepted in the United States of America (GAAP) for complete consolidated financial statements. Certain amounts have been reclassified to conform to current period presentations.

Use of Estimates

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

Critical Accounting Policies

Information with respect to our critical accounting policies which we believe could have the most significant effect on our reported results and require subjective or complex judgments by management is contained on pages 41 to 43 in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, of the Company s Annual Report on Form 10-K for the Year Ended December 31, 2010 (the 2010 Form 10-K). Management believes that there have been no significant changes during the nine months ended September 30, 2011 in our critical accounting policies from those disclosed in Item 7 of the 2010 Form 10-K, except as noted below.

Revenue Recognition. Through August 2010, the Company sold its products in North America through an exclusive distribution relationship with Henry Schein, Inc. (HSIC). Effective August 30, 2010, the Company began selling its products in North America directly to customers through its direct sales force and through non-exclusive distributors, including HSIC. The Company sells its products internationally through exclusive and non-exclusive distributors as well as to direct customers in certain countries. Sales are recorded upon shipment from the Company s facility and payment of the Company s invoices is generally due within 30 days or less. Internationally, the Company sells products through independent distributors, including HSIC in certain countries. The Company records revenue based on four basic criteria that must be met before revenue can be recognized: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred and title and the risks and rewards of ownership have been transferred to our customer, or services have been rendered; (iii) the price is fixed or determinable; and (iv) collectability is reasonably assured.

Sales of the Company s laser systems include separate deliverables consisting of the product, disposables used with the laser systems, installation and training. For these sales, effective January 1, 2011, the Company applies the relative selling price method, which requires that arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. This requires the Company to use (estimated) selling prices of each of the deliverables in the total arrangement. The sum of those prices is then compared to the arrangement, and any difference is applied to the separate deliverable ratably. This method also establishes a selling price hierarchy for determining the selling price of a deliverable, which includes: (1) vendor-specific objective evidence (VSOE) if available, (2) third-party evidence if vendor-specific objective evidence is not available, and (3) estimated selling price if neither vendor-specific nor third-party evidence is available. VSOE is determined based on the value the Company sells the undelivered element to a customer as a stand-alone product. Revenue attributable to the undelivered elements is included in deferred revenue when the product is shipped and is recognized when the related service is performed. Disposables not shipped at time of sale and installation services are typically shipped or installed within 30 days. Training is included in deferred revenue when the product is shipped and is recognized when the related service is performed or upon expiration of time offered under the agreement, typically within six months from date of sale. The adoption of the relative selling price method does not significantly change the value of revenue recognized.

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

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

Extended warranty contracts, which are sold to non-distributor customers, are recorded as revenue on a straight-line basis over the period of the contracts, which is typically one year.

For sales transactions involving used laser trade-ins, the Company recognizes revenue for the entire transaction when the cash consideration is in excess of 25% of the total transaction. The Company values used lasers received at their estimated fair market value at the date of receipt.

The Company recognizes revenue for royalties under licensing agreements for our patented technology when the product using our technology is sold. The Company estimates and recognizes the amount earned based on historical performance and current knowledge about the business operations of our licensees. Historically, the Company s estimates generally have been consistent with amounts reported by the licensees. Licensing revenue related to exclusive licensing arrangements is recognized concurrent with the related exclusivity period.

From time to time, the Company may offer sales incentives and promotions on its products. The cost of sales incentives are recorded at the date at which the related revenue is recognized as a reduction in revenue, increase in cost of revenue or as a selling expense, as applicable, or later, in the case of incentives offered after the initial sale has occurred.

Fair Value of Financial Instruments

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

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal market or, if none exists, the most advantageous market, for the specific asset or liability at the measurement date (referred to as the exit price). The fair value should be based on assumptions that market participants would use, including a consideration of nonperformance risk. Level 1 measurement of fair value is quoted prices in active markets for identical assets or liabilities. All of the Company s investments at September 30, 2011 are valued as Level 1 investments.

Money market securities. Money market securities are cash equivalents, which are included in cash and cash equivalents, and consist of highly liquid investments with original maturities of three months or less. The Company uses quoted active market prices for identical assets to measure fair value. The Company held $774,000 in money market securities at September 30, 2011. The Company had no investments at December 31, 2010.

Liquidity and Management s Plans

The Company has suffered recurring losses from operations and had declining revenues during the three years ended December 31, 2010. As of December 31, 2010, the Company had a working capital deficit. Although the Company s revenues increased for the three and nine months ended September 30, 2011, compared to the comparable periods in 2010, the Company still incurred a loss from operations and a net loss.

The Company s need for additional capital and the uncertainties surrounding its ability to obtain such funding at December 31, 2010, raised substantial doubt about its ability to continue as a going concern, which contemplates that the Company will realize its assets and satisfy its liabilities and commitments in the ordinary course of business. The Company s financial statements do not include adjustments relating to the recoverability of recorded asset amounts or the amounts or classification of liabilities that might be necessary should the Company be unable to continue as a going concern. In order for the Company to discharge its liabilities and commitments in the normal course of business, the Company must sell its products directly to end-users and through distributors; establish profitable operations through increased sales and a reduction of operating expenses; and potentially raise additional funds, principally through the additional sales of securities or debt financings to meet its working capital needs.

The Company intends to increase sales by increasing its product offerings, expanding its direct sales force and expanding its distributor relationships both domestically and internationally. However, the Company cannot guarantee that it will be able to increase sales, reduce expenses or obtain additional funds when needed or that such funds, if available, will be obtainable on terms satisfactory to the Company. If the Company is unable to increase sales, reduce expenses or raise sufficient additional funds it may be unable to continue to fund its operations, develop its products or realize value from its assets and discharge its liabilities in the normal course of business.

At September 30, 2011, the Company had approximately $11.2 million in working capital. The Company s principal sources of liquidity at September 30, 2011 consisted of approximately $5.8 million in cash and cash equivalents and $8.1 million of net accounts receivable.

On April 16, 2010, the Company filed a shelf registration statement (the 2010 Shelf Registration Statement) with the Securities and Exchange Commission (the SEC) to enable the Company to offer for sale, from time to time, in one or more offerings, an unspecified amount of common stock, preferred stock or warrants up to an aggregate public offering price of $9.5 million. The 2010 Shelf Registration Statement (File No. 333-166145) was declared effective by the SEC on April 29, 2010.

In accordance with the terms of a Controlled Equity Offering Agreement (the Offering Agreement) entered into with Ascendiant Securities, LLC (Ascendiant), as sales agent, on December 23, 2010, the Company was entitled to issue and sell up to 3,000,000 shares of Common Stock pursuant to the 2010 Shelf Registration Statement. Sales of shares of the Company s common stock, could be made in a series of transactions over time as the Company may direct Ascendiant in privately negotiated transactions and/or any other method permitted by law, including sales deemed to be an at the market offering as defined in Rule 415 under the Securities Act of 1993, as amended (the 1933 Act). At the market sales include sales made directly on the NASDAQ Capital Market, the existing trading market for our common stock, or sales made to or through a market maker other than on an exchange.

Pursuant to the Offering Agreement, Ascendiant agreed to make all sales using its commercially reasonable best efforts consistent with its normal trading and sales practices, and on terms on which we and Ascendiant mutually agree. Unless the Company and Ascendiant agree to a lesser amount with respect to certain persons or classes of persons, the compensation to Ascendiant for sales of common stock sold pursuant to the Offering Agreement will be 3.75% of the gross proceeds of the sales price per share.

During the quarter ended March 31, 2011, the Company sold approximately 2.2 million shares of common stock with gross proceeds of approximately $7.5 million and net proceeds of approximately $7.1 million, net of commission and direct costs, through the Offering Agreement with Ascendiant. No additional sales under the Offering Agreement have been made since the quarter ended March 31, 2011 and no additional sales will be made under the Offering Agreement.

On April 7, 2011, the Company entered into an agreement with Rodman & Renshaw, LLC (Rodman & Renshaw), pursuant to which Rodman & Renshaw agreed to arrange for the sale of shares of the Company s common stock in a registered direct placement (the April 2011 Registered Direct Placement) pursuant to the 2010 Shelf Registration

Statement with a fee of 4.5% of the aggregate gross proceeds. In addition, on April 7, 2011, the Company and certain institutional investors entered into a securities purchase agreement arranged by Rodman & Renshaw, pursuant to which the Company agreed to sell in the April 2011 Registered Direct Placement an aggregate of 320,000 shares of its common stock with a purchase price of $5.60 per share for gross proceeds of approximately $1.8 million. The net proceeds to the Company from the April 2011 Registered Direct Placement totaled approximately $1.7 million. The costs associated with the April 2011 Registered Direct Placement totaled approximately $124,000 and were paid in April 2011 upon the closing of the transaction. The shares of common stock sold in connection with the April 2011 Registered Direct Placement were issued pursuant to a prospectus supplement dated April 11, 2011 to the 2010 Shelf Registration Statement, which was filed with the SEC.

The transactions described above exhausted the securities available for sale under the Company s 2010 Shelf Registration Statement.

On June 24, 2011, the Company entered into a securities purchase agreement (the June 2011 Securities Purchase Agreement) with certain institutional investors (the June 2011 Purchasers) whereby the Company agreed to sell, and on June 29, 2011 the Company sold, an aggregate of 1,625,947 shares of the Company s common stock at a price of $5.55 per share, together with five-year warrants to purchase 812,974 shares of the Company s common stock having an exercise price of $6.50 per share (the June 2011 Warrants). The June 2011 Warrants are not exercisable for six months following their issuance. Gross proceeds from the offering totaled approximately $9 million, and net proceeds to the Company, after commissions and other offering expenses of approximately $610,000, totaled approximately $8.4 million. The Company will use the proceeds for working capital and general corporate purposes. In connection with the June 2011 Securities Purchase Agreement, the Company entered into an agreement on June 22, 2011 with Rodman & Renshaw in which Rodman & Renshaw agreed to act as the Company s exclusive placement agent for the offering and the Company agreed to pay Rodman & Renshaw commissions in the amount of 5.0% of the gross proceeds of the offering, or approximately $451,000, and reimburse Rodman & Renshaw s expenses up to a maximum amount of $50,000. Commissions and expenses paid to Rodman and Renshaw are included in the $610,000 of offering expenses noted above.

The common stock and the June 2011 Warrants were offered and sold, and the common stock issuable upon exercise of the June 2011 Warrants were offered, pursuant to exemptions from registration set forth in section 4(2) of the 1933 Act and Rule 506 of Regulation D promulgated under the 1933 Act. The common stock, the June 2011 Warrants and the common stock issuable upon exercise of the June 2011 Warrants may not be re-offered or resold absent either registration under the 1933 Act or the availability of an exemption from the registration requirements.

In connection with the June 2011 Securities Purchase Agreement, the Company entered into a registration rights agreement with the June 2011 Purchasers pursuant to which the Company undertook to file a resale registration statement, on behalf of the June 2011 Purchasers with respect to the resale of the common stock and the common stock issuable upon the exercise of the June 2011 Warrants (collectively, the Registerable Securities), no later than July 19, 2011 and to use its reasonable best efforts to cause such registration statement to be declared effective by the SEC not later than September 7, 2011 (or October 7, 2011, if the SEC comments upon the registration statement). If the Company were unable to timely satisfy such deadlines, it could incur penalties of up to 3.0% of the offering proceeds for such non-compliance.

On July 19, 2011, the Company filed a registration statement on Form S-3 (the Selling Stockholders Registration Statement) with the SEC to register the Registerable Securities. The Selling Stockholders Registration Statement (File No. 333-175664) was declared effective by the SEC on August 25, 2011.

On August 2, 2011, the Company repurchased 90,000 of the June 2011 Warrants for $99,900 or $1.11 per underlying share, plus non-accountable expenses of $30,000.

On February 8, 2011, the Company repaid all outstanding balances under a Loan and Security Agreement dated May 27, 2010, as amended, (the Loan and Security Agreement) with MidCap Financial, LLC (whose interests were later assigned to its affiliate MidCap Funding III, LLC) and Silicon Valley Bank, which included $2.6 million in principal, $30,000 of accrued interest and $169,000 of loan related expenses. In connection with the repayment, MidCap Funding III, LLC and Silicon Valley Bank released their security interest in the Company s assets. Unamortized costs totaling approximately $225,000, excluding interest, associated with the term loan payable were expensed in February 2011. MidCap Financial, LLC and Silicon Valley Bank also exercised all of their warrants on a cashless basis during February 2011 for 78,172 shares of common stock.

On September 23, 2010, the Company entered into a Distribution and Supply Agreement (the D&S Agreement) with HSIC, effective August 30, 2010. In connection with the D&S Agreement, as amended, HSIC placed two irrevocable purchase orders for the Company s products totaling $9 million. The first purchase order, totaling $6 million, was for the iLase system and was required to be fulfilled by June 30, 2011. The first purchase order was fully satisfied during the first quarter of 2011. The second purchase order, totaling $3 million, required that the products ordered there under be delivered by August 25, 2011, and was also for the iLase system, but could be modified without charge and applied to other laser products. During April 2011, HSIC modified the type of laser systems ordered on the second purchase order. The second purchase order was fully satisfied during the third quarter of 2011.

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NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

Changes to U.S. GAAP are established by the Financial Accounting Standards Board (the FASB) in the form of accounting standards updates (ASU s) to the FASB s Accounting Standards Codification (ASC).

The Company considers the applicability and impact of all ASU s. ASU s not listed below were assessed and determined to not be applicable or are expected to have minimal impact on our consolidated financial position and results of operations.

Newly Adopted Accounting Standards

In October 2009, the FASB issued an update to existing guidance on accounting for arrangements with multiple deliverables. This update allows companies to allocate consideration received for qualified separate deliverables using estimated selling price for both delivered and undelivered items when vendor-specific objective evidence or third-party evidence is unavailable. Additional disclosures discussing the nature of multiple element arrangements, the types of deliverables under the arrangements, the general timing of their delivery and significant factors and estimates used to determine estimated selling prices is required. This guidance is effective prospectively for interim and annual periods ending after June 15, 2010. The Company adopted this guidance effective January 1, 2011. The adoption did not have a material impact on the Company s consolidated financial statements.

In December 2010, the FASB issued an update to existing guidance on the calculation of impairment of goodwill. This update modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For these reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. The Company adopted this guidance on January 1, 2011, and will evaluate the impact, if any, on its consolidated financial statements if events occur or circumstances change that would more likely than not reduce the fair value of the Company or its assets below their carrying amounts. No events have occurred since June 30, 2011, the Company s testing date that would trigger further impairment testing of the Company s intangible assets with finite lives subject to amortization.

New Accounting Standards Not Yet Adopted

In September 2011, the FASB issued guidance for the impairment testing of goodwill. The guidance permits an entity to first assess qualitative factors to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Management believes that the adoption will not have a material impact on the Company s consolidated financial statements.

In June 2011, the FASB updated the accounting guidance relating to presentation of comprehensive income. This guidance requires companies to present total comprehensive income, the components of net income and the components of other comprehensive income (OCI) either in a single continuous statement of comprehensive income or in two, but consecutive, statements. Additionally, companies are required to present on the face of the consolidated financial statements the reclassification adjustments that are reclassified from OCI to net income, where the components of net income and the components of OCI are presented. This guidance is effective beginning for the year ending December 31, 2012. The adoption of this guidance is not expected to have a material impact on the Company s consolidated financial position or results of operations.

NOTE 3 STOCK-BASED AWARDS AND PER SHARE INFORMATION

Stock-Based Compensation

The Company currently has one stock-based compensation plan, the 2002 Stock Incentive Plan (the 2002 Plan). Eligible persons under the 2002 Plan include certain officers and employees of the Company and directors of the Company. Under the 2002 Plan, 6,950,000 shares of common stock have been authorized for issuance. As of September 30, 2011, 2,269,000 shares of common stock have been issued pursuant to options that were exercised, 3,803,000 shares of common stock has been reserved for options that are outstanding, and 878,000 shares of common stock remain available for future grant.

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Compensation cost related to stock options recognized in operating results during the three months ended September 30, 2011 and 2010 was $324,000 and $113,000, respectively. The net impact to earnings for those periods was $(0.01) and $(0.00) per basic and diluted share, respectively. Compensation cost related to stock options recognized in operating results during the nine months ended September 30, 2011 and 2010, was $1.0 million and $499,000, respectively. The net impact to earnings for those periods was $(0.04) and $(0.02) per basic and diluted share, respectively. At September 30, 2011, the Company had $2.3 million of total unrecognized compensation cost, net of estimated forfeitures, related to unvested share-based compensation arrangements granted under our existing plans. The Company expects that cost to be recognized over a weighted-average period of 1.2 years.
The following table summarizes the income statement classification of compensation expense associated with share-based payments (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Cost of revenue	$ 45	$ 7	$ 111	$ 26
Sales and marketing	75	40	259	146
General and administrative	177	47	536	259
Engineering and development	27	19	94	68
	$ 324	$ 113	$ 1,000	$ 499

The Black-Scholes option valuation model is used in estimating the fair value of traded options. This option pricing model requires the Company to make several assumptions regarding the key variables used to calculate the fair value of its stock options. The risk-free interest rate used is based on the U.S. Treasury yield curve in effect for the expected lives of the options at their dates of grant. Since July 1, 2005, the Company has used a dividend yield of zero as it does not intend to pay cash dividends on its common stock in the foreseeable future. The most critical assumption used in calculating the fair value of stock options is the expected volatility of the common stock. Management believes that the historic volatility of the common stock is a reliable indicator of future volatility, and accordingly, a stock volatility factor based on the historical volatility of the common stock over a period of time is used in approximating the estimated lives of new stock options. The expected term is estimated by analyzing the Company s historical share option exercise experience over a five year period. Compensation expense is recognized using the straight-line method for all stock-based awards. Compensation expense is recognized only for those options expected to vest, with forfeitures estimated at the date of grant based on historical experience and future expectations. Forfeitures are estimated at the time of the grant and revised as necessary in subsequent periods if actual forfeitures differ from those estimates.
The stock option fair values were estimated using the Black-Scholes option-pricing model with the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Expected term (years)	4.30	4.60	4.08	4.75
Volatility	105%	91%	106%	86%
Annual dividend per share	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Risk-free interest rate	1.23%	1.76%	1.70%	2.18%

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A summary of option activity under our stock option plans for the nine months ended September 30, 2011 is as follows:

	Shares	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value(1)
Options outstanding at December 31, 2010	4,130,000	$ 3.60		
Plus: Options granted	893,000	$ 4.50		
Less: Options exercised	(642,000)	$ 2.09		
Options canceled or expired	(578,000)	$ 5.52		
Options outstanding at September 30, 2011	3,803,000	$ 3.78	4.74	$ 2,297,000
Options exercisable at September 30, 2011	1,875,000	$ 4.66	4.79	$ 1,059,000
Options expired during the nine months ended September 30, 2011	304,000	$ 7.94		

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Proceeds from stock options exercised	$ 254	$ 106	$ 1,218	$ 148
Tax benefit related to stock options exercised (1)	N/A	N/A	N/A	N/A
Intrinsic value of stock options exercised (2)	$ 167	$ 45	$ 1,308	$ 75
Weighted-average fair value of options granted during period	$ 2.84	$ 0.85	$ 3.25	$ 1.11
Total fair value of shares vested during the period	$ 311	$ 135	$ 874	$ 494

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

(2) The intrinsic value of stock options exercised is the amount by which the market price of the stock on the date of exercise exceeded the market price of the stock on the date of grant.

Warrants

In May 2010, the Company granted warrants to purchase an aggregate of 101,694 shares of its common stock to MidCap Financial, LLC, and Silicon Valley Bank (the Finance Warrants) at a price per share of $1.77. The exercise price of the Finance Warrants was subsequently reduced to $0.84 during September 2010 in connection with Amendment No. 1 to the Loan and Security Agreement. During February 2011, MidCap Financial, LLC, and Silicon Valley Bank performed a cashless exercise of all of their warrants, which resulted in the issuance of 78,172 shares of unregistered stock.

During September 2010, the Company issued warrants (the IR Warrants) to purchase an aggregate of 50,000 shares of common stock at a price per share of $0.74 to three service providers who provide investor relations services. The IR Warrants vest quarterly and will be revalued each period until the final vesting date. The holders may convert the IR Warrants into a number of shares, in whole or in part. The first tranche of IR Warrants expire on September 20, 2013. Pursuant to the agreement, the service providers were also entitled to a second tranche of IR Warrants to purchase an aggregate of 50,000 shares of common stock at a price per share of $0.74 as a performance bonus when the Company s stock price closes at a price in excess of $6.00. The second tranche of IR Warrants were subsequently issued in April 2011 and will expire on April 11, 2014. During the three and nine month periods ended September 30, 2011, the Company recognized $16,000 and $226,000 of expense, respectively, related to the IR Warrants. The Company accounts for these non-employee stock warrants using the Black Scholes option pricing model, which measures them at the fair value of the equity instruments issued, using the stock price and other measurement assumptions as of the date which the counterparty s performance is complete. The Company has concluded that the vesting date is the ultimate final measurement date, and will revalue any unvested warrants at the end of each reporting period until that date. During the three and nine month periods ended September 30, 2011, 21,000 and 26,000 of the IR Warrants were exercised on a cashless basis resulting in the issuance of 15,802 and 20,160 shares of the Company s common stock, respectively. During the three months ended September 30, 2011, 12,000 of the warrants were exercised for cash.

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In connection with the June 2011 Securities Purchase Agreement, on June 29, 2011, the Company issued warrants to purchase 812,974 shares of common stock at an exercise price of $6.50 per share to the June 2011 Purchasers. The June 2011 Warrants are not exercisable for six months following their issuance and have a term of five years from the date of issuance.

On August 2, 2011, the Company repurchased 90,000 of the June 2011 Warrants for $99,900, or $1.11 per underlying share, plus non-accountable expenses of $30,000.

Net Income (Loss) Per Share Basic and Diluted

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

Outstanding stock options and warrants to purchase 4,588,000 and 3,071,000 shares were not included in the computation of diluted loss per share for the three and nine months ended September 30, 2011 and 2010, respectively, as a result of their anti-dilutive effect.

The Company declared special 1% stock dividends during each of the three completed quarters in fiscal 2011. The stock dividend declared during the quarter ended March 31, 2011 was payable March 31, 2011 to shareholders of record on March 15, 2011; the stock dividend declared during the quarter ended June 30, 2011 was payable June 30, 2011 to shareholders of record on June 10, 2011; and the stock dividend declared during the quarter ended September 30, 2011 was payable September 15, 2011 to shareholders of record on August 29, 2011. Although the Company s Board of Directors has expressed its desire to continue to declare 1% stock dividends in future quarters, the Board of Directors deemed these three dividends to be special dividends and there is no assurance, with respect to amount or frequency, that any stock dividend will be declared again in the future. All stock information presented, other than that related to stock options and warrants, has been adjusted to reflect the effects of the stock dividends.

On August 10, 2011, the Company announced that its Board of Directors has authorized a stock repurchase program, pursuant to which the Company may repurchase up to an aggregate of 2,000,000 shares of the Company s outstanding common stock. The stock repurchase program became effective on August 12, 2011. The Company expects to fund the stock repurchase program with existing cash and cash equivalents on hand. Any shares repurchased will be retired and shall resume the status of authorized and unissued shares. Repurchases of the Company s common stock may be made from time to time through a variety of methods, including open market purchases, privately negotiated transactions or block transactions. The Company has no obligation to repurchase shares under the stock repurchase program, and the timing, actual number and value of the shares that are repurchased will be at the discretion of the Company s management and will depend upon a number of considerations, including the trading price of the Company s common stock, general market conditions, applicable legal requirements and other factors. The stock repurchase program will expire on August 12, 2013, unless the program is completed sooner, suspended, terminated or otherwise extended. During the quarter ended September 30, 2011, the Company had not repurchased any of its shares pursuant to the stock repurchase program.

NOTE 4 INVENTORY

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

	September 30, 2011	December 31, 2010
Raw materials	$ 4,214	$ 3,440
Work-in-process	2,117	1,184
Finished goods	3,492	2,363
Inventory, net	$ 9,823	$ 6,987

Inventory is net of the provision for excess and obsolete inventory of $2.0 million and $1.9 million at September 30, 2011 and December 31, 2010, respectively.

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NOTE 5 PROPERTY, PLANT AND EQUIPMENT

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

	September 30, 2011	December 31, 2010
Land	$ 259	$ 252
Building	333	324
Leasehold improvements	969	914
Equipment and computers	5,862	5,767
Furniture and fixtures	1,036	1,019
Construction in progress	21	55
	8,480	8,331
Accumulated depreciation and amortization	(7,312)	(7,000)
Property, plant and equipment, net	$ 1,168	$ 1,331

Depreciation and amortization of property, plant and equipment was $118,000 and $464,000 for the three and nine months ended September 30, 2011, respectively, and $226,000 and $732,000 for the three and nine months ended September 30, 2010, respectively.

During the year ended December 31, 2010, management adopted a plan to sell its German building and land. In June 2010, the Company received an offer to purchase the land and building in Germany for 435,000, or $531,000 and, as such, the Company recorded an impairment charge of 28,000, or $35,000, as the fair market value was below the carrying value. Fully depreciated assets totaling 231,000, or $282,000, which were no longer usable, were also written off in June 2010. Assets Held for Sale as of December 31, 2010 totaled $576,000. During April 2011, management announced its decision to expand the Company s operations in Europe which includes utilizing the land and building in Germany. As such, the land and building were reclassified from Assets Held for Sale to Property, Plant, and Equipment as of September 30, 2011 and December 31, 2010.

NOTE 6 INTANGIBLE ASSETS AND GOODWILL

The Company conducted its annual impairment test of intangible assets and goodwill as of June 30, 2011, and determined that there was no impairment. The Company also tests its intangible assets and goodwill between the annual impairment test if events occur or circumstances change that would more likely than not reduce the fair value of the Company or its assets below their carrying amounts. No events have occurred since June 30, 2011 that would trigger further impairment testing of the Company s intangible assets and goodwill.

Amortization expense for the three and nine months ended September 30, 2011 was $33,000 and $98,000, respectively, and $33,000 and $98,000, respectively, for the same periods in 2010. Other intangible assets consist of an acquired customer list and a non-compete agreement.

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

	As of September 30, 2011				**As of December 31, 2010**			
	Gross	Accumulated Amortization	Impairment	Net	Gross	Accumulated Amortization	Impairment	Net
Patents (4-10 years)	$ 1,914	$ (1,670)	$	$ 244	$ 1,914	$ (1,572)	$	$ 342
Trademarks (6 years)	69	(69)			69	(69)		
	979		(979)		979		(979)	

Trade names (Indefinite life)								
Other (4 to 6 years)	593	(593)			593	(593)		
Total	$ 3,555	$ (2,332)	$ (979)	$ 244	$ 3,555	$ (2,234)	$ (979)	$ 342
Goodwill (Indefinite life)	$ 2,926			$ 2,926	$ 2,926			$ 2,926

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NOTE 7 ACCRUED LIABILITIES AND DEFERRED REVENUE

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

	September 30, 2011	December 31, 2010
Payroll and benefits	$ 1,633	$ 1,180
Warranty accrual, current portion	2,447	2,301
Sales tax credit	525	429
Deferred rent credit		37
Accrued professional services	676	583
Accrued insurance premium		342
Accrued support services	200	173
Other	278	437
Accrued liabilities	$ 5,759	$ 5,482

Changes in the initial product warranty accrual, and the expenses incurred under our initial and extended warranties, for the three and nine months ended September 30, 2011 and 2010 were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Initial warranty accrual, beginning balance	$ 2,686	$ 2,715	$ 2,725	$ 2,235
Provision for estimated warranty cost	644	798	1,600	2,794
Warranty expenditures	(498)	(661)	(1,493)	(2,177)
Initial warranty accrual, ending balance	2,832	2,852	2,832	2,852
Total warranty accrual, long term	385	636	385	636
Total warranty accrual, current portion	$ 2,447	$ 2,216	$ 2,447	$ 2,216

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

	September 30, 2011	December 31, 2010
Royalty advances from Procter & Gamble	$	$ 375
Undelivered elements (training, installation and product and support services)	899	616
Extended warranty contracts	1,039	1,092
Total deferred revenue	1,938	2,083
Less long-term amounts:		
Royalty advances from Proctor & Gamble		(375)
Extended warranty contracts	(33)	(58)
Total deferred revenue, long-term	(33)	(433)
Total deferred revenue, current portion	$ 1,905	$ 1,650

In June 2006, the Company received a one-time payment from The Procter & Gamble Company (P&G) totaling $3.0 million for a license to certain patents pursuant to a binding letter agreement, subsequently replaced by a definitive agreement effective January 24, 2007 (the 2006 P&G Agreement). Pursuant to the 2006 P&G Agreement, the entire amount was recorded as deferred revenue when received and $1.5 million was recognized in license fees and royalty revenue for each of the years ended December 31, 2008 and 2007. Additionally, beginning with a payment for the third quarter of 2006, P&G was required to make $250,000 quarterly payments until the first product under the agreement was shipped by P&G for large-scale commercial distribution in the United States. Seventy-five percent of each $250,000 payment received was treated as prepaid royalties and was credited against royalty payments and the remainder was credited to revenue. No payments were received from P&G subsequent to December 31, 2008. The Company recognized revenue related to these payments of $0 and $250,000 for the years ended December 31, 2009 and 2008, respectively.

On May 20, 2010, the Company and P&G entered into a license agreement (the 2010 P&G Agreement), effective January 1, 2009 which superseded the prior 2006 P&G Agreement. Pursuant to the 2010 P&G Agreement, the Company agreed to continue granting P&G an exclusive license to certain of the Company s patents to enable P&G to develop products aimed at the consumer market and P&G will pay royalties based on sales of products developed with such intellectual property.

Pursuant to the 2010 P&G Agreement, the prepaid royalty payments previously paid by P&G have been applied to the new exclusive license period which was effective as of January 1, 2009, and continued through December 31, 2010. Previously recorded deferred revenue of $1.5 million, which was accounted for pursuant to the 2006 P&G Agreement, was recognized concurrent with the related exclusivity period. The Company recognized $1.5 million of revenue for the year ended December 31, 2010. As of December 31, 2010, $375,000 remained in long term deferred revenue to be applied against future earned royalties. On June 28, 2011, the Company entered into an amendment to the 2010 P&G Agreement which extended the effective period for the 2010 P&G Agreement from January 1, 2009 through June 30, 2011. The extension of the effective period allowed the Company to recognize the previously deferred $375,000 of revenue as royalty revenue during the quarter ended June 30, 2011.

The 2010 P&G Agreement, as amended, also provides that effective July 1, 2011, P&G s exclusive license to our patents will convert to a non-exclusive license unless P&G pays the Company a $187,500 license payment by the end of the third quarter of 2011, and at the end of each quarter thereafter, during the term of the 2010 P&G Agreement. P&G did not make any payments to the Company in the quarter ended September 30, 2011. The Company is currently engaged in discussions with P&G concerning the sufficiency of P&G s efforts to commercialize a consumer product utilizing our patents and is working with P&G to develop a framework for the parties commercialization efforts.

NOTE 8 BANK LINE OF CREDIT AND DEBT

On May 27, 2010, the Company entered into the Loan and Security Agreement with MidCap Financial, LLC, whose interests were later assigned to its affiliate MidCap Funding III, LLC, and Silicon Valley Bank. The Loan and Security Agreement evidenced a $5 million term loan, of which $3 million was borrowed on such date. In connection with the Loan and Security Agreement, the Company issued two Secured Promissory Notes in an aggregate principal amount of $3 million, at 14.25%, secured by the Company s assets, and warrants to purchase up to an aggregate of 101,694 shares of Common Stock at an exercise price of $1.77 per share with an expiration date of May 26, 2015.

On August 10, 2010, the Company entered into a Forbearance Agreement pursuant to which MidCap Funding III, LLC and Silicon Valley Bank agreed not to exercise their rights and remedies for a certain period of time with respect to the Company s non-compliance with a financial covenant in the Loan and Security Agreement. On September 23, 2010, the Company entered into Waiver and Amendment No. 1 to the Loan and Security Agreement which, among other things, waived its non-compliance at certain testing dates, with a financial covenant contained in the Loan and Security Agreement and amended the per share price of the warrants to $0.84.

On February 4, 2011, MidCap Financial, LLC and Silicon Valley Bank exercised all of their warrants on a cashless basis for 54,893 and 23,279 shares of common stock, respectively.

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

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

On February 8, 2011, the Company repaid all outstanding balances under the Loan and Security Agreement, which included $2.6 million in principal, $30,000 of accrued interest and $169,000 of loan related expenses, and MidCap Funding III, LLC and Silicon Valley Bank released their security interest in the Company s assets. Unamortized costs totaling approximately $225,000, excluding interest, associated with the term loan payable were expensed in February 2011.

In December 2010, the Company financed approximately $389,000 of insurance premiums payable in nine equal monthly installments of approximately $43,000 each, including a finance charge of 2.92%. As of September 30, 2011, there were no amounts outstanding under this arrangement.

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NOTE 9 COMMITMENTS AND CONTINGENCIES

Legal Proceedings

The Company discloses material loss contingencies deemed to be reasonably possible and accrues for loss contingencies when, in consultation with the Company s legal advisors, the Company concludes that a loss is probable and reasonably estimable. Except as otherwise indicated, the possible losses relating to the matters described below are not reasonably estimable. The ability to predict the ultimate outcome of such matters involves judgments, estimates and inherent uncertainties. The actual outcome of such matters could differ materially from management s estimates.

Intellectual Property Litigation

During April 2010, Discus Dental LLC (Discus) and Zap Lasers LLC (Zap) filed a lawsuit against the Company in the United States District Court for the Central District of California (the U.S. District Court), related to the Company s iLase diode laser. The lawsuit alleged claims for patent infringement, federal unfair competition, common law trademark infringement and unfair competition, fraud and violation of the California Unfair Trade Practices Act. In May 2010, Discus and Zap filed a First Amended Complaint (the Complaint) which removed the allegations for fraud as well as certain claims for trademark infringement and unfair competition. In July 2010, Discus informed the U.S District Court that it had acquired Zap and requested that Zap be dropped as a party to the lawsuit and Discus became the sole plaintiff in the suit. Discus was subsequently acquired by Royal Philips Electronics N.V. (Philips) on October 11, 2010. Discus and Philips settled all of their claims against the Company in June 2011 for a nominal amount. As a result, the Complaint, as amended, filed with the U.S. District Court was dismissed in its entirety with prejudice in July 2011.

Other Matters

In the normal course of business, the Company is subject to other legal proceedings, lawsuits and other claims. Although the ultimate aggregate amount of probable monetary liability or financial impact with respect to these matters is subject to many uncertainties and is therefore not predictable with assurance, management believes that any monetary liability or financial impact to the Company from these other matters, individually and in the aggregate, would not be material to the Company s financial condition, results of operations or cash flows. However, there can be no assurance with respect to such result, and monetary liability or financial impact to the Company from these other matters could differ materially from those projected.

NOTE 10 SEGMENT INFORMATION

The Company currently operates in a single business segment. For the three and nine month periods ended September 30, 2011, sales in the United States accounted for approximately 50% and 66% respectively, of net revenue, and international sales accounted for approximately 50% and 34%, respectively, of net revenue. For the three and nine month periods ended September 30, 2010, sales in the United States accounted for approximately 64% and 59% respectively, of net revenue, and international sales accounted for approximately 36% and 41%, respectively, of net revenue.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
United States	$ 6,551	$ 3,984	$ 23,685	$ 9,739
International	6,510	2,236	12,016	6,768
	$ 13,061	$ 6,220	$ 35,701	$ 16,507

Long-lived assets located outside of the United States at our foreign subsidiaries were $574,000 and $584,000 as of September 30, 2011 and December 31, 2010, respectively.

NOTE 11 CONCENTRATIONS

Revenue from Waterlase systems, the Company s principal product, comprised 63% and 57% of total net revenue for the three and nine month periods ended September 30, 2011, respectively, and 31% and 28% of total net revenue, respectively, for the same periods in 2010. Revenue from Diode systems comprised 17% and 21% of total net revenue for the three and nine month periods ended September 30, 2011, respectively, and 34% and 26%, for the same periods of 2010.

Approximately 14% and 24% of the Company s net revenue in the three and nine month periods ended September 30, 2011 was generated through sales to HSIC worldwide. Approximately 38% of the Company s net revenue in both the three and nine month periods ended September 30, 2010 was generated through sales to HSIC worldwide.

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There were no sales concentrations greater than 10% within any individual country outside the United States for the three and nine month periods ended September 30, 2011 and 2010.

The Company maintains its cash and cash equivalent accounts with established commercial banks. Such cash deposits periodically exceed the Federal Deposit Insurance Corporation insured limit.

There were no accounts receivable concentrations from any one distributor in excess of 10% at September 30, 2011 and there were accounts receivable concentrations from one international distributor in the amount of $430,000, or 13%, at December 31, 2010.

The Company currently purchases certain key components of its products from single suppliers. Although there are a limited number of manufacturers of these key components, management believes that other suppliers could provide similar key components on comparable terms. A change in suppliers, however, could cause a delay in manufacturing and a possible loss of sales, which would adversely affect the Company s results of operations.

NOTE 12 COMPREHENSIVE INCOME (LOSS)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net loss	$ (953)	$ (2,726)	$ (2,456)	$ (12,195)
Other comprehensive income (loss) items:				
Foreign currency translation adjustments	(120)	227	41	(67)
Comprehensive loss	$ (1,073)	$ (2,499)	$ (2,415)	$ (12,262)

NOTE 13 INCOME TAXES

Our effective tax rate was (4.01%) and (2.84%) for the three and nine month periods ended September 30, 2011, respectively, as compared to (1.04%) and (0.43%) for three and nine month periods ended September 30, 2010. Our effective rates differ from the U.S. federal statutory rate primarily due to our U.S. and foreign deferred tax asset valuation allowance position, foreign taxes and state taxes.

As of December 31, 2010, we had cumulative unrecognized tax benefit of approximately $91,000, which if recognized, would increase our annual effective tax rate. We do not expect that our unrecognized tax benefit will change significantly within the next 12 months. There have been no material changes to the unrecognized tax benefit during the three and nine month periods ended September 30, 2011.

We periodically evaluate likelihood of the realization of deferred tax assets, and adjust the carrying amount of the deferred tax assets by the valuation allowance to the extent the future realization of the deferred tax assets is not judged to be more likely than not. We considered many factors when assessing the likelihood of future realization of our deferred tax assets, including any recent cumulative earnings experience by taxing jurisdictions, expectations of future taxable income or loss, the carryforward periods available to us for tax reporting purposes and other relevant factors.

At December 31, 2010, we had federal and state net operating loss (NOL) carryforward balances of approximately $66.1 million and $41.0 million respectively, which began to expire in 2011. In addition, we had federal and state tax credits of approximately $665,000 and $458,000 respectively. Federal credits will begin to expire in 2018 and the state tax credits carryforward indefinitely.

As of December 31, 2010, based on the weight of available evidence, including cumulative losses in recent years and expectations regarding future taxable income, realization of our deferred tax assets does not appear more likely than not and, as such, we have recorded a valuation allowance of approximately $34.3 million. In addition, we recorded a deferred tax liability related to its indefinite-lived other intangible assets that is not expected to reverse in the foreseeable future resulting in a net deferred tax liability of approximately $533,000. As of September 30, 2011, due to uncertainties surrounding the timing of realizing tax benefits of NOL carryforwards in the future, we continue to carry the full valuation allowance net of the naked liability.

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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 as defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause the results of Biolase Technology, Inc. (the Company, we , us or our) to differ materially and adversely from those expressed or implied by such forward-looking statements. Such forward-looking statements include any statements, predictions and expectations regarding our earnings, revenue, sales and operations, operating expenses, anticipated cash needs, capital requirements and capital expenditures, needs for additional financing, use of working capital, plans for future products and services and for enhancements of existing products and services, anticipated growth strategies, ability to attract customers, sources of net revenue, anticipated trends and challenges in our business and the markets in which we operate, the adequacy of our facilities, the impact of economic and industry conditions on our customers and our business, customer demand, our competitive position, the outcome of any litigation against us, the perceived benefits of any technology acquisitions, critical accounting policies, the impact of recent accounting pronouncements, statements pertaining to financial items, plans, strategies, expectations or objectives of management for future operations, our financial condition or prospects, and any other statement that is not historical fact. Forward-looking statements are often identified by the use of words such as may, might, will, intend, should, could, can, would, continue, expect, believe, anticipate, estimate, predict, potential, plan, seek and similar expressions and variations or the negativities of these terms or other comparable terminology. These forward-looking statements are based on the beliefs and assumptions of our management based upon information currently available to management. Such forward looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially and adversely from future results expressed or implied such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified under Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010 (the 2010 Form 10-K) filed with the Securities and Exchange Commission (the SEC). Such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements for any reason except as otherwise required by law.

Overview

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

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

We have suffered recurring losses from operations and during the three fiscal years ended December 31, 2010 had declining revenues. As of December 31, 2010, we had a working capital deficit. For the nine months ended September 30, 2011, although our revenues increased compared to the same period in 2010, we still incurred losses from operations and a net loss.

Our audited financial statements as of and for the year ended December 31, 2010, were prepared assuming that we would continue to operate as a going concern. Our need for additional capital and the uncertainties surrounding our ability to obtain such funding at December 31, 2010, raised substantial doubt about our ability to continue as a going concern, which contemplates that we will realize our assets and satisfy our liabilities and commitments in the ordinary course of business. Our financial statements do not include adjustments relating to the recoverability of recorded asset amounts or the amounts or classification of liabilities that might be necessary should we be unable to continue as a going concern.

Accordingly, we have taken steps during the year ending December 31, 2011 (Fiscal 2011) which we believe have improved our financial condition and will ultimately improve our financial results. These steps include: raising additional equity, principally through the sales of securities, to meet our working capital needs; repaying our credit facility; and restructuring our exclusive distribution agreements and expanding our direct sales force and distributor relationships both domestically and internationally.

Additional Equity

The 2010 Shelf Registration Statement. On April 16, 2010, we filed a shelf registration statement (the 2010 Shelf Registration Statement) with the Securities and Exchange Commission (the SEC) in order to offer for sale, from time to time, in one or more offerings, an unspecified amount of common stock, preferred stock or warrants up to an aggregate public offering price of $9.5 million. The 2010 Shelf Registration Statement was declared effective by the SEC on April 29, 2010.

In accordance with the terms of a Controlled Equity Offering Agreement (the Offering Agreement) entered into with Ascendiant Securities, LLC (Ascendiant), as sales agent, on December 23, 2010, we may issue and sell up to 3,000,000 shares of common stock pursuant to the 2010 Shelf Registration Statement. Sales of shares of our common stock, may be made in a series of transactions over time as we may direct Ascendiant in privately negotiated transactions and/or any other method permitted by law, including sales deemed to be an at the market offering as defined in Rule 415 under the Securities Act of 1993, as amended (the 1933 Act). At the market sales include sales made directly on the NASDAQ Capital Market, the existing trading market for our common stock, or sales made to or through a market maker other than on an exchange.

During the quarter ended March 31, 2011, we sold approximately 2.2 million shares of common stock with gross proceeds of approximately $7.5 million and net proceeds of approximately $7.1 million, net of commission and direct costs, through the Offering Agreement with Ascendiant. No additional sales under the Offering Agreement have been made since the quarter ended March 31, 2011 and no additional sales will be made under the Offering Agreement.

On April 7, 2011, we entered into an agreement with Rodman & Renshaw, LLC (Rodman & Renshaw), pursuant to which Rodman & Renshaw agreed to arrange for the sale of shares of our common stock in a registered direct public offering (the April 2011 Registered Direct Placement) pursuant to the 2010 Shelf Registration Statement with a fee of 4.5% of the aggregate gross proceeds. In addition, on April 7, 2011, we and certain institutional investors entered into a securities purchase agreement arranged by Rodman & Renshaw, pursuant to which we agreed to sell in the April 2011 Registered Direct Placement an aggregate of 320,000 shares of our common stock with a purchase price of $5.60 per share for gross proceeds of approximately $1.8 million. The net proceeds to us from the April 2011 Registered Direct Placement totaled approximately $1.7 million. The costs associated with the April 2011 Registered Direct Placement totaled approximately $124,000 and were paid in April 2011 upon the closing of the transaction. The shares of common stock sold in connection with the April 2011 Registered Direct Placement were issued pursuant to a prospectus supplement dated April 11, 2011 to the 2010 Shelf Registration Statement, which was filed with the SEC. The transactions described above exhausted the securities available for sale under our 2010 Shelf Registration Statement.

The Selling Stockholders Registration Statement. On June 24, 2011, we entered into a securities purchase agreement (the June 2011 Securities Purchase Agreement) with certain institutional investors (the June 2011 Purchasers) whereby we agreed to sell, and on June 29, 2011 sold, an aggregate 1,625,947 shares of our common stock at a price of $5.55 per share, together with five-year warrants to purchase 812,974 shares of our common stock having an exercise price of $6.50 per share, first exercisable six month after issuance (the June 2011 Warrants). Net proceeds totaled approximately $8.4 million, after commissions and other offering expenses totaling approximately $610,000. The common stock and the June 2011 Warrants were offered and sold, and the common stock issuable upon exercise of the June 2011 Warrants were offered, pursuant to exemptions from registration set forth in section 4(2) of the 1933 Act and Rule 506 of Regulation D promulgated under the 1933 Act. The common stock, the June 2011 Warrants and the common stock issuable upon exercise of the June 2011 Warrants may not be re-offered or resold absent either registration under the 1933 Act or the availability of an exemption from the registration requirements.

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In connection with the June 2011 Securities Purchase Agreement, we entered into a registration rights agreement with the June 2011 Purchasers pursuant to which we undertook to file a resale registration statement, on behalf of the June 2011 Purchasers with respect to the resale of the common stock and the common stock issuable upon the exercise of the June 2011 Warrants (collectively, the Registerable Securities), no later than July 19, 2011 and to use our reasonable best efforts to cause such registration statement to be declared effective by the SEC not later than September 7, 2011 (or October 7, 2011, if the SEC comments upon the registration statement). If we are unable to timely satisfy such deadlines, we could incur penalties of up to 3.0% of the offering proceeds for such non-compliance.

On July 19, 2011, we filed a registration statement on Form S-3 (the Selling Stockholders Registration Statement) with the SEC to register the Registerable Securities which was declared effective by the SEC on August 25, 2011.

On August 2, 2011, we repurchased 90,000 of the June 2011 Warrants for $99,900 or $1.11 per underlying share, plus expenses of $30,000.

Repayment of Credit Facility Debt

On February 8, 2011, we repaid all outstanding balances under a Loan and Security Agreement dated May 27, 2010, as amended, (the Loan and Security Agreement) with MidCap Financial, LLC (whose interests were later assigned to its affiliate MidCap Funding III, LLC) and Silicon Valley Bank, which included $2.6 million in principal, $30,000 of accrued interest and $169,000 of loan related expenses. In connection with the repayment, MidCap Funding III, LLC and Silicon Valley Bank released their security interest in our assets. Unamortized costs totaling approximately $225,000, excluding interest, associated with the term loan payable were expensed in February 2011. MidCap Financial, LLC and Silicon Valley Bank also exercised all of their warrants on a cashless basis during February 2011 for 78,172 shares of common stock. As of November 10, 2011, we do not have a credit agreement.

Restructuring Exclusive Distribution Agreement

On September 23, 2010, we entered into a Distribution and Supply Agreement (the D&S Agreement) with Henry Schein, Inc. (HSIC), effective August 30, 2010. In connection with the D&S Agreement, as amended, HSIC placed two irrevocable purchase orders for our products totaling $9 million. The first purchase order, totaling $6 million, was for the iLase system and was required to be fulfilled by June 30, 2011. The first purchase order was fully satisfied during the first quarter of 2011. The second purchase order, totaling $3 million, required that the products ordered there under be delivered by August 25, 2011, and was also for the iLase system, but could be modified without charge and applied to other laser products. During April 2011, HSIC modified the type of laser systems ordered on the second purchase order. The second purchase order was fully satisfied during the third quarter of 2011.

Critical Accounting Policies

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America which require us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and revenues and expenses reported during the period. Information with respect to our critical accounting policies which we believe could have the most significant effect on our reported results and require subjective or complex judgments by management is contained on pages 41 to 43 in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, of the 2010 Form 10-K. Management believes that there have been no significant changes during the nine months ended September 30, 2011 in our critical accounting policies from those disclosed in Item 7 of on the 2010 Form 10-K, except as noted below.

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

(iv) collectability is reasonably assured.

Sales of our laser systems include separate deliverables consisting of the product, disposables used with the laser systems, installation and training. For these sales, effective January 1, 2011, we apply the relative selling price method, which requires that arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. This requires us to use (estimated) selling prices of each of the deliverables in the total arrangement. The sum of those prices is then compared to the arrangement, and any difference is applied to the separate deliverable ratably. This method also establishes a selling price hierarchy for determining the selling price of a deliverable, which includes: (1) vendor-specific objective evidence (VSOE) if available, (2) third-party evidence if vendor-specific objective evidence is not available, and (3) estimated selling price if neither vendor-specific nor third-party evidence is available. VSOE is determined based on the value we sell the undelivered element to a customer as a stand-alone product. Revenue attributable to the undelivered elements is included in deferred revenue when the product is shipped and is recognized when the related service is performed. Disposables not shipped at time of sale and installation services are typically shipped or installed within 30 days. Training is included in deferred revenue when the product is shipped and is recognized when the related service is performed or upon expiration of time offered under the agreement, typically within six months from date of sale. The adoption of the relative selling price method does not significantly change the value of revenue recognized.

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

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

Extended warranty contracts, which are sold to our non-distributor customers, are recorded as revenue on a straight-line basis over the period of the contracts, which is typically one year.

For sales transactions involving used laser trade-ins, we recognize revenue for the entire transaction when the cash consideration is in excess of 25% of the total transaction. We value used lasers received at their estimated fair market value at the date of receipt.

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

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

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Results of Operations

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

Consolidated Statements of Operations Data:	Three Months Ended September 30, 2011	2010	Nine Months Ended September 30, 2011	2010
Net revenue	100.0%	100.0%	100.0%	100.0%
Cost of revenue	59.3	71.2	55.8	75.8
Gross profit	40.7	28.8	44.2	24.2
Operating expenses:				
Sales and marketing	24.6	33.9	24.3	47.4
General and administrative	15.2	21.4	16.6	30.5
Engineering and development	8.1	12.5	9.1	18.1
Total operating expenses	47.9	67.8	50.0	96.0
Loss from operations	(7.2)	(39.0)	(5.8)	(71.8)
Non-operating loss, net	0.3	(4.4)	(0.9)	(1.8)
Loss before income tax provision	(6.9)	(43.4)	(6.7)	(73.6)
Income tax provision	0.4	0.4	0.2	0.3
Net loss	(7.3)%	(43.8)%	(6.9)%	(73.9)%

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

	Three Months Ended September 30, 2011		2010		Nine Months Ended September 30, 2011		2010	
Waterlase systems	$ 8,214	63%	$ 1,896	31%	$ 20,204	57%	$ 4,586	28%
Diode systems	2,169	17%	2,098	34%	7,643	21%	4,311	26%
Imaging systems	100	1%		0%	100	0%		0%
Consumables and Service	2,564	19%	2,008	32%	7,335	21%	6,188	37%
Products and services	13,047	100%	6,002	97%	35,282	99%	15,085	91%
License fee and royalty	14	0%	218	3%	419	1%	1,422	9%
Net revenue	$ 13,061	100%	$ 6,220	100%	$ 35,701	100%	$ 16,507	100%

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

	Three Months Ended September 30, 2011	2010	Nine Months Ended September 30, 2011	2010

United States	$ 6,551	$ 3,984	$ 23,685	$ 9,739
International	6,510	2,236	12,016	6,768
Net revenue	$ 13,061	$ 6,220	$ 35,701	$ 16,507

Three months ended September 30, 2011 and 2010

Net Revenue. Net revenue for the three months ended September 30, 2011 was $13.1 million, an increase of $6.9 million, or 110%, as compared to net revenue of $6.2 million for the three months ended September 30, 2010. Laser system net revenue (Waterlase and Diode systems combined) increased by approximately $6.4 million, or 160%, for the three months ended September 30, 2011 compared to the three months ended September 30, 2010. Sales of our Waterlase systems increased $6.3 million, or 333%, in the three months ended September 30, 2011 compared to the three months ended September 30, 2010 primarily due to sales of the Waterlase iPlus system after its introduction in early 2011 in connection with the Company s return to a direct and multi-distributor sales model. Revenues from our diode systems increased $71,000, or 3%, during the three months ended September 30, 2011 compared to the three months ended September 30, 2010. The increase resulted primarily from increased direct sales of our ezlase systems. Imaging system net revenue was $100,000 for the three months ended September 30, 2011. We did not sell any Imaging Systems prior to the quarter ended September 30, 2011.

Consumables and service net revenue (which includes consumable products, advanced training programs and extended service contracts) and shipping revenue increased by approximately $556,000 or 28% for the three months ended September 30, 2011, as compared to the three months ended September 30, 2010. This was primarily driven by an increase of $362,000, or 33%, in the sales of our consumables products while services revenues increased $194,000 or 21% for the three months ended September 30, 2011, as compared to the three months ended September 30, 2010. This increase in consumable and service net revenue is primarily a result of our decision to recommence selling our products in North America directly to consumers and through non-exclusive distributor arrangements (rather than exclusively through a single distributor) and the launch of our Biolase Store in late 2010.

License fees and royalty revenue decreased $204,000, or 94%, for the three months ended September 30, 2011, as compared to the three months ended September 30, 2010. The decrease resulted primarily from the recognition of deferred Proctor & Gamble (P&G) royalties of $187,500 in the three months ended September 30, 2010.

Cost of Revenue. Cost of revenue for the three months ended September 30, 2011 increased by $3.3 million, or approximately 75%, to $7.7 million, compared with cost of revenue of $4.4 million for the three months ended September 30, 2010. This increase is primarily attributable to increases in sales. Although cost of revenue increased during the three months ended September 30, 2011 on an absolute basis as compared to the three months ended September 30, 2010, cost of revenue actually decreased, when expressed as a percentage of net revenues, from 71% of net revenues in the three months ended September 30, 2010 to 59% of net revenues in the three months ended September 30, 2011.

Gross Profit. Gross profit for the three months ended September 30, 2011 increased by $3.5 million to $5.3 million, or 41% of net revenue, during the three months ended September 30, 2011 from $1.8 million, or, 29% of net revenue, for the three months ended September 30, 2010. The increase was primarily due to higher sales volumes, better utilization of fixed costs and reduced expenses, partially offset by the decline in P&G royalties and reduced margins from a higher volume of international revenue.

Operating Expenses. Operating expenses for the three months ended September 30, 2011 increased by $2.1 million, or 48%, to $6.3 million as compared to $4.2 million for the three months ended September 30, 2010 and decreased as a percentage of net revenue from 68% to 48%. This increase was primarily attributable to costs necessary to grow our top line revenue as explained in the following expense categories:

Sales and Marketing Expense. Sales and marketing expenses for the three months ended September 30, 2011 increased by $1.1 million to $3.2 million, or 25% of net revenue, as compared with $2.1 million, or 34% of net revenue, for the three months ended September 30, 2010. The increase in expenses resulted primarily from increased payroll and related expenses of $191,000, increased commissions of $315,000, increased travel expenses of $160,000, increased convention related expenses of $210,000 and increased advertising and product literature expenses of $91,000 in the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. These increases were integral in the strategy for increasing revenue.

General and Administrative Expense. General and administrative expenses for the three months ended September 30, 2011 increased by $657,000 to $2.0 million, or 15% of net revenue, as compared with $1.3 million, or 21% of net revenue, for the three months ended September 30, 2010. The increase in general and administrative expenses resulted primarily from increased payroll and consulting expenses of $184,000, increased professional service fees of $249,000, increased investor relations cost of $51,000 and increased bank fees of $56,000.

Engineering and Development Expense. Engineering and development expenses for the three months ended September 30, 2011 increased by $277,000 to $1.1 million, or 8% of net revenue, as compared with $775,000, or 12% of net revenue, for the three months ended September 30, 2010. The increase was primarily related to increased payroll and consulting expenses of $175,000 in the three months ended September 30, 2011 compared with the three months ended September 30, 2010.

Non-Operating Income (Loss)

(Loss) Gain on Foreign Currency Transactions. We recognized a $44,000 gain on foreign currency transactions for the three months ended September 30, 2011, compared to a $118,000 loss on foreign currency transactions for the three months ended September 30, 2010 due to the changes in exchange rates between the U.S. dollar and the Euro, the Australian dollar and the New Zealand dollar.

Interest Expense. Interest expense consists primarily of interest on the financing of our business insurance premiums and interest on our term loan payable which was funded in May 2010 and repaid in full in February 2011. Interest expense, excluding the amortization of debt related costs, totaled approximately $2,000 and $112,000 for three months ended September 30, 2011 and 2010, respectively.

Net Loss. For the reasons above, net loss was $953,000 for the three months ended September 30, 2011 compared to a net loss of $2.7 million for the three months ended September 30, 2010. Our loss for the three months ended September 30, 2011, was primarily due to unanticipated expenses in costs of revenues related to the introduction of our new Waterlase iPlus system and increased payroll and consulting expenses in our operating expenses to support our growing operations. The decrease in our net loss for the three months ended September 30, 2011, when compared to the three months ended September 30, 2010, was primarily due to our increased sales volumes and improved cost controls.

Nine months ended September 30, 2011 and 2010

Net Revenue. Net revenue for the nine months ended September 30, 2011 was $35.7 million, an increase of $19.2 million, or 116%, as compared with net revenue of $16.5 million for the nine months ended September 30, 2010.

Laser system net revenue (Waterlase and Diode systems combined) increased by approximately $18.9 million, or 213%, in the nine months ended September 30, 2011 compared to the same period of 2010. Sales of our Waterlase systems increased $15.6 million, or 341%, in the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 primarily due to sales of the Waterlase iPlus system after its introduction in early 2011 in connection with the Company s return to a direct and multi-distributor sales model. Revenues from our diode systems increased $3.3 million, or 77%, in the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010. The increase resulted primarily from volume sales of the ilase system to a domestic distributor and increased direct sales of our ezlase system.

Imaging system net revenue was $100,000 for the nine months ended September 30, 2011. We did not sell any Imaging Systems prior to the current fiscal year.

Consumables and service net revenue increased by approximately $1.1 million, or 19%, for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. Consumable products revenue increased $978,000, or 32%, and services revenues decreased $168,000, or 5%, during the nine months ended September 30, 2011, as compared to the same period of 2010. This increase in consumable and service net revenue is primarily a result of our decision to recommence selling our products in North America directly to consumers and through non-exclusive distributor arrangements (rather than exclusively through a single distributor) and the launch of our Biolase Store in late 2010.

License fees and royalty revenue decreased approximately $1 million to approximately $419,000 in the nine months ended September 30, 2011 compared to $1.4 million in the nine months ended September 30, 2010. The decrease resulted primarily from the recognition of $375,000 of deferred P&G royalties in the nine months ended September 30, 2011 as compared to the recognition of $1.3 million of deferred P&G royalties in the nine months ended September 30, 2010.

Cost of Revenue. Cost of revenue for the nine months ended September 30, 2011 increased by $7.4 million, or approximately 59%, to $19.9 million, compared with cost of revenue of $12.5 million for the nine months ended September 30, 2010. This increase is primarily attributable to increases in sales. Although cost of revenue increased in the nine months ended September 30, 2011 on an absolute basis as compared to the nine months ended September 30, 2010, cost of revenue actually decreased when expressed as a percentage of net revenues, from 76% of net revenues for the nine months ended September 30, 2010 to 56% of net revenues for the nine months ended September 30, 2011.

Gross Profit. Gross profit for the nine months ended September 30, 2011 increased by $11.8 million to $15.8 million, or 44% of net revenue, as compared with gross profit of $4.0 million, or 24% of net revenue, for the nine months ended September 30, 2010. The increase was primarily due to higher sales volumes, better utilization of fixed costs, and reduced expenses. These factors were partially offset by strategic price concessions to luminaries in the dental field, increased costs related to the launch of the Waterlase iPlus system, the decline in P&G royalties and reduced margins from a higher volume of international revenue during the nine months ended September 30, 2011.

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Operating Expenses. Operating expenses for the nine months ended September 30, 2011 increased by $2.0 million, or 13%, to $17.8 million as compared to $15.8 million in the nine months ended September 30, 2010 and decreased as a percentage of net revenue from 96% to 50%, as explained in the following expense categories:

Sales and Marketing Expense. Sales and marketing expenses for the nine months ended September 30, 2011 increased by $855,000 to $8.7 million, or 24% of net revenue, as compared with $7.8 million, or 47% of net revenue, for the nine months ended September 30, 2010. The increase in expenses resulted primarily from increased payroll and consulting related expenses of $41,000, increased commissions of $609,000, increased travel expenses of $140,000, increased convention related expenses of $323,000, partially offset by decreased media and advertising expenses of $345,000 primarily from additional costs incurred related to the launch of the iLase system during the nine months ended September 30, 2010.

General and Administrative Expense. General and administrative expenses for the nine months ended September 30, 2011 increased by $882,000 to $5.9 million, or 17% of net revenue, as compared with $5.0 million, or 30% of net revenue for the nine months ended September 30, 2010. The increase in general and administrative expenses resulted primarily from increased payroll and consulting expenses of $318,000, increased professional service fees of $437,000, and increased bank fees of $153,000. These increases were partially offset by decreased audit fees of $108,000.

Engineering and Development Expense. Engineering and development expenses for the nine months ended September 30, 2011 increased by $248,000 to $3.2 million, or 9% of net revenue, as compared with $3.0 million, or 18% of net revenue, for the nine months ended September 30, 2010. The increase was primarily related to increased payroll and consulting expenses of $279,000 in the nine months ended September 30, 2011 compared with the nine months ended September 30, 2010.

Non-Operating Income (Loss)

(Loss) Gain on Foreign Currency Transactions. We recognized a $10,000 loss on foreign currency transactions for the nine months ended September 30, 2011, compared to a $75,000 loss on foreign currency transactions for the nine months ended September 30, 2010 due to the changes in exchange rates between the U.S. dollar and the Euro, the Australian dollar and the New Zealand dollar.

Interest Expense. Interest expense consists primarily of interest on the financing of our business insurance premiums and interest on our term loan payable which was funded in May 2010 and repaid in full in February 2011. Interest expense, excluding the amortization of debt related costs, totaled approximately $81,000 and $171,000 for the nine months ended September 30, 2011 and 2010, respectively.

Nonrecurring Charge for the Expense of Unamortized Debt-Related Costs. Unamortized debt-related costs in the amount of $225,000 were expensed in the nine months ended September 30, 2011 in conjunction with the repayment of our outstanding balances under the Loan and Security Agreement during February 2011.

Net Loss. Our net loss was $2.5 million for the nine months ended September 30, 2011 compared to a net loss of $12.2 million for the nine months ended September 30, 2010. Our net loss for the nine months ended September 30, 2011, was primarily due to unanticipated expenses in costs of revenues related to the introduction of our new Waterlase iPlus system and increased payroll and consulting expenses in our operating expenses to support our growing operations. The decrease in our net loss for the nine months ended September 30, 2011, when compared to the nine months ended September 30, 2010, was primarily due to our increased sales volumes.

Liquidity and Capital Resources

At September 30, 2011, we had approximately $11.2 million in working capital. Our principal sources of liquidity at September 30, 2011 consisted of approximately $5.8 million in cash and cash equivalents and $8.1 million of net accounts receivable. We define cash and cash equivalents as highly liquid deposits with original maturities of 90 days or less when purchased. The following table summarizes our statements of cash flows (in millions):

	Nine Months Ended	
	September 30, 2011	September 30, 2010
Net cash flow provided by (used in):		

Operating activities	$ (11,302)	$ (3,567)
Investing activities	(294)	(220)
Financing activities	15,633	3,063
Effect of exchange rate changes	26	(25)
Net increase (decrease) in cash and cash equivalents	$ 4,063	$ (749)

Operating Activities

Net cash used in operating activities during the nine months ended September 30, 2011 was $11.3 million, compared to cash used in operating activities of $3.6 million during for the nine months ended September 30, 2010. Cash flow from operating activities consists of our net loss, adjusted for our non-cash charges, plus or minus working capital changes. Net cash used in working capital changes totaled $11.2 million for the nine months ended September 30, 2011, compared to net cash provided by working capital changes of $7.2 million for the prior year period. The most significant changes in operating assets and liabilities for the nine months ended September 30, 2011, as reported in our consolidated statements of cash flows, were increases of $4.8 million in accounts receivable (before the change in allowance for doubtful accounts) as a result of increased sales towards the end of the period and a $5.7 million decrease in customer deposits as we fully satisfied the remainder of both purchase orders with HSIC during the nine months ended September 30, 2011.

Investing Activities

Cash used in investing activities for the nine months ended September 30, 2011 consisted of $294,000 of capital expenditures. For the fiscal year ending December 31, 2011, we expect capital expenditures to total approximately $500,000, and depreciation and amortization to be approximately $750,000.

Financing Activities

Net cash provided by financing activities for the nine months ended September 30, 2011 was $15.6 million compared to $3.1 million provided by financing activities in the prior year period. Net cash provided by financing activities was derived from the offerings of our common stock pursuant to the 2010 Shelf Registration Statement ($8.8 million in net proceeds), the June 2011 Securities Purchase ($8.4 million in net proceeds) and $1.2 million in proceeds from the exercise of stock options and warrants. Net cash used in financing activities for the nine months ended September 30, 2011 consisted of $2.7 million used for the repayment of our outstanding balances under the Loan and Security Agreement and $130,000 used for the repurchase of 90,000 of the June 2011 Warrants. See Overview above.

Future Liquidity Needs

Our capital requirements will depend on many factors, including, among other things, the rate at which our business grows, the corresponding demands for working capital and manufacturing capacity and any acquisitions that we may pursue. From time to time, we could be required, or may otherwise attempt, to raise capital through either equity or debt offerings. We cannot provide assurance that we will enter into any such equity or debt arrangements in the future or that the required capital would be available on acceptable terms, if at all, or that any such financing activity would not be dilutive to our stockholders.

Litigation and Contingencies

On July 28, 2011, we entered into a 36 month, cancellable operating lease, which will replace the current operating lease we have for our service vehicles. The new lease provides for a down payment of approximately $92,000 and future monthly payments of approximately $13,000 per month. The vehicles are expected to be delivered in November 2011.

For more information on liabilities that may arise from litigation and contingencies, see Note 9 to the Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

Off-Balance Sheet Arrangements

As part of our on-going business, we have not participated in transactions that generate material relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities (SPEs), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of September 30, 2011, we are not involved in any material unconsolidated SPEs.

Recent Accounting Pronouncements

For a description of recently issued and adopted accounting pronouncements, including the respective dates of adoption and expected effects on our results of operation and financial condition, please refer to Part I, Item 1, Note 2 of the Notes to Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, which is incorporated herein by this reference.

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Additional Information

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For quantitative and qualitative disclosures about market risk affecting the Company, see Quantitative and Qualitative Disclosures About Market Risk in Item 7A of Part II of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, which is incorporated herein by reference. Our exposure to market risk has not changed materially since December 31, 2010.

ITEM 4. CONTROLS AND PROCEDURES.

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of the end of the period covered by this report (the Evaluation Date). Based on this evaluation, our principal executive officer and principal financial officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective such that the information relating to the Company, including our consolidated subsidiaries, required to be disclosed in our SEC reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company s management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our most recently completed fiscal quarter. Based on that evaluation, our principal executive officer and principal financial officer concluded that there has not been any change in our internal control over financial reporting during that quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION.

ITEM 1. LEGAL PROCEEDINGS.

For a description of our legal proceedings, please refer to Part I, Item 1, Note 9 to the Notes to the Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, which is incorporated herein by reference in response to this Item.

ITEM 1A. RISK FACTORS.

There have been no material changes to the risk factors as disclosed in Part I, Item 1A Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

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ITEM 6. EXHIBITS

The exhibits listed below are hereby filed with the SEC as part of this Quarterly Report on Form 10-Q. Certain of the following exhibits have been previously filed with the SEC pursuant to the requirements of the Securities Act or the Exchange Act. Such exhibits are identified in the chart to the right of the Exhibit and are incorporated herein by reference.

			Incorporated by Reference			
Exhibit	**Description**	**Filed Herewith**	**Form**	**Period Ending/Date of Report**	**Exhibit**	**Filing Date**
3.1.1	Restated Certificate of Incorporation, including, (i) Certificate of Designations, Preferences and Rights of 6% Redeemable Cumulative Convertible Preferred Stock of the Registrant; (ii) Certificate of Designations, Preferences and Rights of Series A 6% Redeemable Cumulative Convertible Preferred Stock of The Registrant; (iii) Certificate of Correction Filed to Correct a Certain Error in the Certificate of Designation of The Registrant; and (iv) Certificate of Designations of Series B Junior Participating Cumulative Preferred Stock of the Registrant.		S-1, Amendment No. 1	12/23/2005	3.1	12/23/2005
3.1.2	Fifth Amended and Restated Bylaws of The Registrant, adopted on July 1, 2010		8-K	07/02/2010	3.1	07/07/2010
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14 and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended	X				
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14 and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended	X				
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350,	X				

	as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	
101*	The following financial information from the Company s Quarterly Report on Form 10-Q, for the period ended June 30, 2011, formatted in eXtensible Business Reporting Language: (i) Consolidated Balance Sheets, (ii) Consolidated Income Statements, (iii) Consolidated Statements of Cash Flows, (iv) Notes to Consolidated Financial Statements	X

* Pursuant to Rule 406T of Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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SIGNATURES

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

Date: November 10, 2011

BIOLASE TECHNOLOGY, INC.,
a Delaware Corporation
(registrant)

By: /s/ FEDERICO PIGNATELLI
Federico Pignatelli
Chief Executive Officer
(Principal Executive Officer)

By: /s/ FREDERICK D. FURRY
Frederick D. Furry
Chief Operating Officer and Chief Financial Officer
(Principal Financial and Accounting Officer)