Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006

OR

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

For the transition period _____ to _____ .

Commission file number: 000-50644

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

Delaware	**77-0492262**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. employer identification no.)**

3240 Bayshore Blvd., Brisbane, California 94005
(Address of principal executive offices)

(415) 657-5500
(Registrant's telephone number, including area code)

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

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

The number of shares of Registrant's common stock issued and outstanding as of October 31, 2006 was 12,755,798.

Table of Contents

CUTERA, INC.
FORM 10-Q
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
CUTERA, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)
(unaudited)

	September 30, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 3,058	$ 5,260
Marketable investments	87,614	86,736
Accounts receivable, net	9,124	6,478
Inventory	5,558	5,245
Deferred tax asset	6,711	3,027
Other current assets	3,998	3,728
Total current assets	116,063	110,474
Property and equipment, net	992	1,015
Intangibles, net	1,515	469
Total assets	$ 118,570	$ 111,958
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 1,396	$ 1,352
Accrued liabilities	12,657	9,131
Deferred revenue	3,126	1,673
Total current liabilities	17,179	12,156
Deferred rent	1,342	1,096
Deferred revenue, net of current portion	2,242	1,469
Deferred tax liability	60	60
Total liabilities	20,823	14,781
Stockholders' equity:		
Common stock	13	12
Additional paid-in capital	81,510	77,705
Deferred stock-based compensation	(482)	(2,171)
Retained earnings	16,751	21,743
Accumulated other comprehensive loss	(45)	(112)
Total stockholders' equity	97,747	97,177
Total liabilities and stockholders' equity	$ 118,570	$ 111,958

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

CUTERA, INC
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net revenue	$25,059	$18,950	$ 70,211	$51,667
Cost of revenue	7,931	4,746	21,510	13,642
Gross profit	17,128	14,204	48,701	38,025
Operating expenses:				
Sales and marketing	8,174	6,222	25,025	17,854
Research and development	1,679	1,334	4,538	3,932
General and administrative	2,992	1,924	11,615	6,519
Litigation settlement	544	—	18,935	—
Total operating expenses	13,389	9,480	60,113	28,305
Income (loss) from operations	3,739	4,724	(11,412)	9,720
Interest and other income, net	829	549	2,615	1,351
Income (loss) before income taxes	4,568	5,273	(8,797)	11,071
Provision (benefit) for income taxes	1,618	1,472	(3,805)	3,080
Net income (loss)	$ 2,950	$ 3,801	$ (4,992)	$ 7,991
Net income (loss) per share:				
Basic	$ 0.23	$ 0.33	$ (0.40)	$ 0.70
Diluted	$ 0.21	$ 0.27	$ (0.40)	$ 0.58
Weighted-average number of shares used in per share calculations:				
Basic	12,675	11,661	12,460	11,369
Diluted	14,238	13,924	12,460	13,681

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

CUTERA, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	2006	2005
Cash flows from operating activities:		
Net income (loss)	$ (4,992)	$ 7,991
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	636	503
Change in allowance for doubtful accounts	(63)	(296)
Provision for excess and obsolete inventory	90	434
Change in deferred taxes	(3,684)	612
Stock-based compensation	3,231	1,202
Tax benefit from stock option exercises	—	3,125
Changes in assets and liabilities:		
Accounts receivable	(2,583)	1,608
Inventory	(403)	(2,430)
Other current assets	(270)	(1,635)
Accounts payable	44	430
Accrued liabilities	3,414	359
Deferred rent	246	336
Deferred revenue	2,226	579
Net cash provided by (used in) operating activities	(2,108)	12,818
Cash flows from investing activities:		
Acquisition of property and equipment	(441)	(414)
Acquisition of intangibles	(1,218)	(165)
Proceeds from sales of marketable investments	12,303	18,294
Proceeds from maturities of marketable investments	76,693	34,373
Purchase of marketable investments	(89,807)	(70,995)
Net cash used in investing activities	(2,470)	(18,907)
Cash flows from financing activities:		
Proceeds from exercise of stock options and employee stock purchase plan	2,376	3,747
Net cash provided by financing activities	2,376	3,747
Net decrease in cash and cash equivalents	(2,202)	(2,342)
Cash and cash equivalents at beginning of period	5,260	7,070
Cash and cash equivalents at end of period	$ 3,058	$ 4,728
Supplemental and non-cash disclosure of cash flow information:		
Change in deferred stock-based compensation, net of terminations	$ (1,261)	$ 1,393

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

CUTERA, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation

The condensed consolidated financial statements include the accounts of Cutera, Inc. (the "Company"), a Delaware corporation, and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated.

The financial information furnished is unaudited. The condensed consolidated financial statements included in this report reflect all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for the fair statement of the results of operations for the interim periods covered and of the financial condition of the Company at the date of the interim balance sheet. The December 31, 2005 condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The results for interim periods are not necessarily indicative of the results for the entire year or any other interim period. The condensed consolidated financial statements should be read in conjunction with the Company's financial statements and the notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2005 filed with the Securities and Exchange Commission ("SEC") on March 16, 2006.

Significant Accounting Policies

The Company's significant accounting policies are disclosed in the Company's annual report on Form 10-K for the year ended December 31, 2005 and have not changed significantly as of September 30, 2006, with the exception of the following policies:

Stock-Based Compensation

Effective January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)"), using the modified prospective transition method and therefore has not restated results for prior periods. Under this transition method, stock-based compensation expense for the first nine months of fiscal 2006 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). Stock-based compensation expense for all stock-based compensation awards granted after January 1, 2006 is based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). The Company recognizes these compensation costs on a straight-line basis over the requisite service period of the award, which is generally the vesting term of four years. Prior to the adoption of SFAS 123(R) the Company recognized stock-based compensation expense in accordance with Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees." In March 2005, the SEC issued Staff Accounting Bulletin ("SAB") No. 107 *Share-Based Payment* regarding the SEC's interpretation of SFAS 123(R) and the valuation of stock-based payments for public companies. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R). See Note 2 for a further discussion on stock-based compensation.

Intangible assets

Purchased technology licenses and other intangible assets are presented at cost, net of accumulated amortization. The technology licenses are being amortized on a straight-line basis over their expected useful life of 9-10 years and the other intangibles are being amortized over their expected useful life of two years.

Recent Accounting Pronouncements

In September 2006, the SEC issued SAB No. 108 regarding the process of quantifying financial statement misstatements. SAB No. 108 states that registrants should use both a balance sheet approach and an income statement approach when quantifying and evaluating the materiality of a misstatement. The interpretations in SAB No. 108 contain guidance on correcting errors under the dual approach as well as provide transition guidance for correcting errors. This interpretation does not change the requirements within SFAS No. 154, "Accounting Changes and Error Corrections- a replacement of APB No. 20 and Financial Accounting Standards Board ("FASB") Statement No. 3," for the correction of an error on financial statements. SAB No. 108 is effective for annual financial statements covering the first fiscal years ending after November 15, 2006. The Company will be required to adopt this interpretation by December 31, 2006. Management is currently evaluating the requirements of SAB No. 108 and the impact this interpretation may have on the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This standard defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America, and expands disclosure about fair value measurements. This pronouncement applies under other accounting standards that require or permit fair value measurements. Accordingly, this statement does not require any new fair value measurement. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company will be required to adopt SFAS No. 157 in the first quarter of fiscal year 2008. Management is currently evaluating the requirements of SFAS No. 157 and has not yet determined the impact on the consolidated financial statements.

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" effective for fiscal years beginning after December 15, 2006. The Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting for interim periods, disclosure, and transition. The Company will decide on its policy for interest and penalty classification by the end of 2006 and adopt the Interpretation beginning with the fiscal year ending 2007. Upon adoption, it is not expected that the Interpretation will have a material effect on the Company's financial position or results of operations.

Note 2. Accounting for Stock-Based Compensation

Periods Prior to the Adoption of SFAS 123(R)

Prior to January 1, 2006, the Company accounted for stock-based compensation under the recognition and measurement provisions of APB 25. Accordingly, the Company generally recognized compensation expense only when it granted options with a discounted exercise price. Any resulting compensation expense was recognized ratably over the associated service period, which was generally the option vesting term of four years. Effective January 1, 2006, the Company adopted SFAS 123(R), using the modified prospective application transition method, which requires the presentation of pro-forma information for periods prior to the adoption of SFAS 123(R) regarding the net income and net income per share as if the Company had accounted for its stock options under the fair value method of SFAS 123. For the purpose of this pro-forma disclosure, the estimated value of the stock awards is recognized on a straight line basis over the vesting periods of the awards. If compensation had been determined based upon the fair value at the grant date for employee compensation arrangements, consistent with the methodology prescribed in SFAS 123, the Company's pro-forma net income and pro-forma net income per share under SFAS 123 would have been as shown in the table below (in thousands, except per share data):

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net income, as reported	$ 3,801	$ 7,991
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	224	716
Less: Total stock-based employee compensation determined under fair-valued based method for all awards, net of related tax effects	(624)	(1,558)
Pro forma net income used in basic and diluted net income per share	$ 3,401	$ 7,149
Basic net income per share:		
As reported	$ 0.33	$ 0.70
Pro forma	$ 0.29	$ 0.63
Diluted net income per share:		
As reported	$ 0.27	$ 0.58
Pro forma	$ 0.25	$ 0.53

Stock Option Plans

As of September 30, 2006, the Company had the below mentioned stock-based employee compensation plans.

2004 Employee Stock Purchase Plan

The Company sponsors the 2004 Employee Stock Purchase Plan ("2004 ESPP"), pursuant to which eligible employees are permitted to purchase common stock at a discount through payroll deductions. The price of the common stock purchased is equal to 85% of the fair market value of the common stock at the beginning of an offering period or at the end of a purchase period. Shares of common stock eligible for purchase are increased on the first day of each fiscal year by an amount equal to the lesser of (i) 600,000 shares, (ii) 2.0% of the outstanding shares of common stock on such date or (iii) an amount as determined by the Board of Directors. Each offering period includes two six-month purchase periods. The Company added 244,269 reserved shares to the 2004 ESPP on January 1, 2006, bringing the total authorized shares from inception-to-date of 663,413 shares.

As of January 1, 2006 the Company had 569,855 shares available for purchase. During the nine months ended September 30, 2006, the Company issued 24,798 shares and as of September 30, 2006, 545,057 shares remained available for future purchases. Beginning with the offering period that started on November 1, 2006, all future offering periods under the 2004 ESPP will run for approximately six months, each with one purchase period.

2004 Equity Incentive Plan and 1998 Stock Plan

The Company has two stock option plans - the 1998 Stock Plan (the "1998 Plan") and the 2004 Equity Incentive Plan. Shares of common stock approved under the 2004 Equity Incentive Plan will be increased on the first day of each fiscal year, by an amount equal to the lesser of: (i) 5% of the outstanding shares of the first day of such year; (b) 2 million shares; or, (c) an amount determined by the Company's board. On January 1, 2006, the Company added 610,674 shares to the 2004 Equity Incentive Plan, bringing the total authorized shares from inception-to-date under the 2004 Equity Incentive Plan and the 1998 Plan to 7,558,534 shares. As of September 30, 2006, a total of 1,714,734 shares of common stock were available for issuance pursuant to the 2004 Equity Incentive Plan and the 1998 Plan.

Options granted under the 1998 Plan and 2004 Equity Incentive Plan may be incentive stock options or non-statutory stock options. Stock purchase rights, or restricted stock units, may also be granted under the 2004 Equity Incentive Plan. Incentive stock options may only be granted to employees. The Board of Directors determines the period over which options become exercisable, however, except in the case of options granted to officers, directors and consultants, options shall become exercisable at a rate of no less than 20% per year over five years from the date the options are granted. Options are to be granted at an exercise price not less than the fair market value per share on the grant date for incentive options or 85% of fair market value for nonqualified stock options. The Company has not granted any discounted options since fiscal 2003. Options granted under the Plan generally become exercisable 25% on the first anniversary of the vesting commencement date and an additional 1/48th of the total number of shares subject to the option shares shall become exercisable on the last day of each calendar month thereafter until all of the shares have become exercisable. The terms of the Company's options are either five, seven or ten years from the date of grant.

During the year ended December 31, 2005, under the 2004 Equity Incentive Plan, the Company's Board of Directors approved the grant of performance unit awards (more commonly referred to as restricted stock units) for a total aggregate of 71,500 shares of restricted stock units to selected members of the Company's management. These restricted stock unit awards are independent of option grants and will not vest if employment terminates prior to the release of the restrictions. These restricted stock unit awards vest in four equal, annual installments on the anniversaries of the date of grant. Restricted stock units do not have the voting rights of common stock, and the shares underlying the restricted stock units are not considered issued and outstanding until they vest and are issued. The Company expenses the cost of the restricted stock unit awards, which is determined to be the fair market value of the shares at the date of grant, ratably over the period during which the restrictions lapse - generally four years from the grant date. During the nine months ended September 30, 2006, the Company did not award any additional restricted stock units and issued 17,502 shares with an aggregate fair value of $317,000, or $18.11 per share, upon the vesting of previously awarded restricted stock units.

Option Activity

Activity under the 1998 Plan and 2004 Equity Incentive Plan is summarized as follows:

	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Weighted-Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value (in $ millions)*
Balances, December 31, 2005	1,479,622	3,244,609	$ 6.91		
Additional shares reserved	610,674	—			
Options granted	(553,943)	553,943	$ 24.10		
Options exercised		(488,406)	$ 3.80		
Options cancelled or forfeited	172,194	(172,194)	$ 17.11		
Restricted stock units forfeited	6,187	—			

Balances, September 30, 2006	1,714,734	3,137,952	$ 9.87	5.96	$ 52.5
Exercisable as of September 30, 2006		1,952,651	$ 4.31	4.82	$ 43.5

* Based on the closing stock price of the Company's common stock of $26.59 on September 29, 2006.

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the Company's closing stock price on the last trading day of the third quarter of fiscal 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 29, 2006. This amount changes based on the fair market value of the Company's common stock. Total intrinsic value of options exercised in the three and nine months ended September 30, 2006 was $1.9 million and $9.9 million, respectively. Total fair value of vested and expensed stock options, restricted stock units and ESPP shares for the three and nine months ended September 30, 2006 was $858,000 and $2.2 million, net of tax, respectively. The Company issues new shares upon the exercise of options, restricted stock units and ESPP shares.

Impact of Adoption of SFAS 123(R)

As a result of adopting the fair value recognition provisions of SFAS 123(R), the impact to the Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2006 from stock-based compensation is as follows *(in thousands, except per share data)* :

	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006
Stock-based compensation expense by award type:		
Employee stock options granted at their intrinsic value	$ (962)	$ (2,295)
Employee stock options granted below their deemed intrinsic fair value prior to the Company's initial public offering	(143)	(428)
Employee stock purchase plan	(62)	(270)
Restricted stock units	(66)	(238)
Total stock-based compensation	(1,233)	(3,231)
Tax effect on stock-based compensation at the Company's marginal tax rate	375	1,034
Effect on net income	$ (858)	$ (2,197)
Effect on net income per share:		
Basic	$ (0.07)	$ (0.18)
Diluted	$ (0.06)	$ (0.18)
Change in deferred stock-based compensation		
Due to reversal of unamortized deferred stock-based compensation upon adoption	$ —	$ (1,237)
Due to reversal of unamortized deferred stock-based compensation for terminations of employee stock options granted below their deemed intrinsic fair value prior to the Company's initial public offering (1)	(6)	(24)
	$ (6)	$ (1,261)

(1) This amount would also have been recorded under the provisions of APB 25, prior to the adoption of FAS 123(R).

As of January 1, 2006, the Company had an unrecorded deferred stock-based compensation balance related to stock options of $7.1 million before estimated forfeitures. In the Company's pro forma disclosures prior to the adoption of SFAS 123(R), the Company accounted for forfeitures when they actually occurred. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised if necessary in subsequent periods if actual forfeitures differ from those estimates. Under SFAS 123(R), the Company estimated that $160,000 of the unrecorded deferred stock-based compensation amount as of January 1, 2006 will not be recognized due to forfeitures.

During the nine months ended September 30, 2006, the Company granted stock options for 553,943 shares of common stock with an estimated total grant-date fair value of $7.8 million. Of the grant-date fair value of options granted in the nine months ended September 30, 2006, the Company estimates that the amount of unrecorded deferred stock-based compensation that is not expected to vest due to forfeiture is $253,000. As of September 30, 2006, the unrecognized compensation cost, net of expected forfeitures, related to non-vested stock options was $9.1 million, which will be recognized using the straight-line attribution method over an estimated weighted-average amortization period of 1.4 years.

As of September 30, 2006, the unrecognized compensation cost related to ESPP shares was $70,000, which will be recognized using the straight-line attribution method over 0.4 years.

As of January 1, 2006, the Company had an unrecorded deferred stock-based compensation balance related to restricted stock unit awards of $1.2 million before estimated forfeitures. Under SFAS 123(R), the Company estimated that $343,000 of the unrecorded deferred stock-based compensation amount as of January 1, 2006 will not be recognized due to forfeitures. As of September 30, 2006, the unrecognized compensation cost related to restricted stock unit awards was $757,000, after estimated forfeitures, which will be recognized over an estimated weighted average amortization period of 2.7 years.

Valuation Assumptions

The Company estimates the fair value of employee stock options and ESPP using a Black-Scholes option-pricing model, consistent with the provisions of SFAS 123(R), SAB 107, and the Company's prior period pro forma disclosures of net income, including stock-based compensation (determined under a fair value method as prescribed by SFAS 123). The fair value of each option grant and each stock issuance under the ESPP was estimated on the date of grant using the Black-Scholes model with the following weighted-average assumptions:

	Three Months Ended, September 30,		Nine Months Ended September 30	
	2006	2005	2006	2005
Employee stock options:				
Risk-free interest rate	4.9%	4.1%	4.9%	3.9%
Expected volatility	62%	67%	64%	67%
Expected dividend yield	0.0%	0.0%	0.0%	0.0%
Expected life (in years)	5.3	3.8	5.0	3.8
Fair value per option granted	$ 11.99	$ 10.20	$ 14.07	$ 9.22
Employee stock purchase plan:				
Risk-free interest rate	4.6%	3.6%	4.3%	3.1%
Expected volatility	60%	51%	56%	51%
Expected dividend yield	0.0%	0.0%	0.0%	0.0%

Expected life (in years)	0.8	0.8	0.8	0.7
Fair value per share purchase	$ 9.96	$ 5.19	$ 8.85	$ 4.70

Option-pricing models require the input of various subjective assumptions, including the option's expected life and the price volatility of the underlying stock.

Expected Volatility: The expected stock price volatility is based on a combination of the Company's historical volatility combined with the weighted average of the volatility of other similar companies in the same industry. With effect from April 2006, the expected stock price volatility was based on a combination of the Company's historical volatility combined with the implied volatility of the Company's quoted stock options. The Company believes these methods of computing volatility are more reflective and a better indicator of the expected future volatility, than using an average of a comparable market index or of a comparable company in the same industry.

Expected Term: The expected term of options granted in the nine months ended September 30, 2006, was based on the Company's historical exercise behavior for ten year term options. For five and seven year term options, that the Company started granting in the second quarter of 2006, the expected term was derived from the short-cut method described in SEC's SAB No. 107.

Risk-Free Interest Rate : The risk-free rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

Expected Dividend: The Company has not paid and does not anticipate paying any dividends in the near future.

Estimated Pre-vesting Forfeitures: When estimating forfeitures, the Company considers voluntary termination behavior based on actual historical information.

Note 3 – Net income (loss) per share

Basic net income (loss) per share is calculated based on net income (loss) and the weighted-average number of shares of common stock outstanding during the reported period. Diluted net income (loss) per share is calculated by increasing the weighted-average number of common shares outstanding during the period- if not anti-dilutive- by the number of additional shares of common stock that would have been outstanding if the dilutive potential shares of common stock had been issued. The dilutive effect of potential common stock (including outstanding stock options, ESPP shares, non-employee director stock units and restricted stock units) is reflected in diluted net income per share by application of the treasury stock method, which includes consideration of share-based compensation as required by SFAS 123(R) in the fiscal quarter and nine months ended September 30, 2006.

A reconciliation of weighted-average basic shares outstanding to weighted-average diluted shares outstanding follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Weighted-average number of common shares outstanding used in computing basic net income (loss) per share	12,675	11,661	12,460	11,369
Dilutive potential common shares used in computing diluted net income (loss) per share	1,563	2,263	—	2,312
Total weighted-average number of shares used in computing diluted net income (loss) per share	14,238	13,924	12,460	13,681

For the quarter and nine months ended September 30, 2006 and 2005, the following stock-based instruments were excluded from the calculation of diluted earnings per share, as their effect was anti-dilutive (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Options to purchase common stock	783	—	2,691	53
Restricted stock units	—	—	61	17
Employee stock purchase plan shares	—	—	51	—
	783	—	2,803	70

Note 4. Inventory

Inventory consists of the following (in thousands):

	September 30, 2006	December 31, 2005
Raw materials	$ 3,222	$ 3,071
Finished goods	2,336	2,174
	$ 5,558	5,245

Note 5. Intangible Assets

Intangible assets are principally comprised of a technology sublicense acquired in 2002; a patent license acquired from Palomar in 2006; and other intangibles. The components of intangible assets were as follows (in thousands):

	As of September 30, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Patent license	$ 1,218	$ 69	$ 1,149
Technology sublicense	538	234	304
Other intangibles	165	103	62
Total	$ 1,921	$ 406	$ 1,515

	As of December 31, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Technology sublicense	$ 538	$ 193	$ 345
Other intangibles	165	41	124
Total	$ 703	$ 234	$ 469

For the nine months ended September 30, 2006 and 2005, amortization expense for intangible assets was $172,000 and $61,000, respectively.

Based on intangible assets recorded at September 30, 2006, and assuming no subsequent additions to, or impairment of the underlying assets, the remaining estimated annual amortization expense is expected to be as follows (in thousands):

Fiscal year ending December 31:	
2006 remainder	$ 69
2007	233
2008	192
2009	192
2010	192
Thereafter	637
Total	$1,515

Note 6. Warranty and Service Contracts

Warranty reserve

The Company has a direct field service organization in the United States, Canada, Switzerland, Germany, Australia and Japan that provides service for its products in these countries. The Company has third party service providers in all other locations. The Company generally provides a warranty with its products, depending on the type of product. After the warranty period, maintenance and support are offered on a service contract basis or on a time and materials basis. The Company currently provides for the estimated cost to repair or replace products under warranty at the time of sale. The warranty reserve activity for the nine months ended September 30, 2006 and 2005 was as follows (in thousands):

	September 30, 2006	September 30, 2005
Balance at December 31, 2005 and 2004	$ 2,043	$ 1,850
Add: Accruals for warranties issued in 2006 and 2005	4,383	1,818
Less: Settlements made during the period	(3,325)	(1,832)
Balance at September 30, 2006 and 2005	$ 3,101	$ 1,836

Deferred service contract revenue

Service contract revenue is recognized on a straight-line basis over the period of the applicable service contract. The deferred service contract revenue activity for the nine months ended September 30, 2006 and 2005 was as follows (in thousands):

	September 30, 2006	September 30, 2005
Balance at December 31, 2005 and 2004	$ 3,117	$ 1,906
Add: Payments received	4,836	2,290
Less: Revenue recognized	(2,740)	(1,641)
Balance at September 30, 2006 and 2005	$ 5,213	$ 2,555

Costs incurred under service contracts during the three months ended September 30, 2006 and 2005, amounted to $419,000 and $304,000, respectively. For the nine months ended September 30, 2006 and 2005, costs incurred under service contracts amounted to $1,261,000 and $795,000, respectively. All service contract costs are recognized as incurred.

Note 7. Comprehensive Income

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net income (loss)	$ 2,950	$ 3,801	$(4,992)	$7,991
Unrealized gain (loss) on marketable investments	106	(37)	67	(40)
Comprehensive income (loss)	$ 3,056	$ 3,764	$(4,925)	$7,951

Note 8. Provision (Benefit) for Income Tax

The interim effective income tax rate is based on management's best estimate of the annual effective income tax rate. The effective tax rates for the three and nine months ended September 30, 2006, were 35% and 43%, respectively. Applying these effective tax rates to income before income taxes for the quarter and nine month ended September 30, 2006, resulted in a tax provision of $1.6 million and tax benefit of $3.8 million, respectively. For the three and nine months ended September 30, 2005, the effective tax rate was 28%.

Undistributed earnings of the Company's foreign subsidiaries of approximately $901,000 and $383,000 at September 30, 2006 and 2005, respectively, are considered to be indefinitely reinvested and, accordingly, no provision for federal and state income taxes has been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, the Company would be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to various foreign countries.

Note 9. Litigation Settlement

The Company was the defendant in two lawsuits brought against it by a competitor, Palomar Medical Technologies. ("Palomar"). In the first suit, filed in February 2002 in the United States District Court, District of Massachusetts, Palomar alleged that by making, using, selling or offering for sale the CoolGlide CV, CoolGlide Excel, CoolGlide Vantage and CoolGlide Xeo products, the Company was willfully and deliberately infringing U.S. Patent No. 5,735,844. This patent concerns a method and apparatus for removing hair with light energy. Massachusetts General Hospital ("MGH") later joined the lawsuit as an additional plaintiff, since Palomar is the exclusive licensee, and MGH is the owner, of the patent at issue in the lawsuit. In the second lawsuit, filed with the same court in April 2005, the plaintiffs alleged that by making, using, selling or offering for sale products that utilize pulsed-light technology for hair removal, the Company was willfully and deliberately infringing U.S. Patent Nos. 5,735,844 and 5,595,568. In both lawsuits, the plaintiffs were seeking to enjoin the Company from selling products found to infringe these patents, and to obtain compensatory and treble damages, reasonable costs and attorney's fees, and other relief as the court deemed just and proper.

On June 2, 2006, the litigation between the Company and Palomar and MGH was settled - with Palomar granting the Company an irrevocable license to the subject patents. Under the terms of the settlement agreements, the Company agreed to pay Palomar a good-faith estimated payment of $22.0 million, representing the Company's estimate of royalties due on past sales of the infringing systems, plus accrued interest and reimbursement of Palomar's legal costs through March 31, 2006.

During the quarter ended June 30, 2006, the Company completed a calculation of the actual amounts owed to Palomar through March 31, 2006 and estimated the amount due to be $19,561,000. In the quarter ended September 30, 2006, after further discussions with Palomar, the Company revised its estimate of the total settlement amount owed to Palomar through March 31, 2006 to $20,153,000. The actual amounts owed to Palomar are subject to change after a review by an independent public accountant hired by Palomar, however, the amount of such change is not expected to be material. This audit is ongoing and is expected to be completed by December 31, 2006.

Of the $20,153,000 revised settlement amount, $18,935,000 relating to past royalties, interest and legal settlement costs, was recorded as a litigation settlement expense; and $1,218,000, representing the value of the on-going license agreement, was capitalized as an intangible asset. The intangible asset is being amortized on a straight line basis over the useful economic life of the patents, which expire in February 2015. The remaining balance from the $22 million good-faith estimated payment made, of $1,847,000, has been used to offset royalty amounts due to Palomar for the six months ended September 30, 2006.

The royalty rate for future sales of hair-removal-only systems will be equal to 7.5% of net sales. For multi-application systems containing hair-removal functionality, the royalty rate will either be 3.75% or 5.25%, depending on whether there is one or two hair-removal technologies included in the system, respectively. The Company's revenue from systems that do not include hair-removal capabilities and revenue from service contracts is not subject to royalties. The royalty cost incurred from April 1, 2006 has been recorded as a component of cost of revenue. These royalty obligations will continue for applicable sales made through February 2015 – which is the expiration date for the subject patents.

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

Caution Regarding Forward-Looking Statements

The following discussion should be read in conjunction with the attached financial statements and notes thereto, and with our audited financial statements and notes thereto for the fiscal year ended December 31, 2005 as contained in our annual report on Form 10-K filed with the SEC on March 16, 2006. This quarterly report, including the following sections, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that involve risks and uncertainties. These statements include, but are not limited to, statements relating to our expectations as to the ability to continue to grow our business, revenue and operating expense for the fourth quarter ending on December 31, 2006, capital expenditures and requirements, growth in our operations and the impact of exchange rate volatility. These forward-looking statements involve risks and uncertainties. The cautionary statements set forth below and those contained in Part II, Item 1A—"Risk Factors" commencing on page 17, identify important factors that could cause actual results to differ materially from those predicted in any such forward-looking statements. The reader is cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of this report. We undertake no obligation to update forward-looking statements to reflect events or circumstances occurring after the date of this Form 10-Q.

Introduction

Management's discussion and analysis of financial condition and results of operations, or MD&A, is provided as a supplement to the accompanying condensed consolidated financial statements and footnotes contained in Item 1 of this report to provide an understanding of our results of operations, financial condition and changes in financial condition. The MD&A is organized as follows:

- *Executive summary*. This section provides a general description and history of our business, a brief discussion of our product lines and the opportunities, trends, challenges and risks we focus on in the operation of our business.
- *Critical accounting policies and estimates.* This section describes the key accounting policies that are affected by critical accounting estimates. In addition, it includes a summary of recent accounting pronouncements that may be applicable to us.
- *Results of operations.* This section provides our analysis and outlook for the significant line items on our consolidated statement of operations.
- *Liquidity and capital resources*. This section provides an analysis of our liquidity and cash flows, as well as a discussion of our commitments that existed as of September 30, 2006.

Executive Summary

Company Description. We are a global medical device company specializing in the design, development, manufacture, marketing and servicing of laser and other light-based aesthetic systems to the professional aesthetic market. Our easy-to-use families of products—CoolGlide, Xeo and Solera—enable dermatologists, plastic surgeons, gynecologists, primary care physicians and other qualified practitioners to perform safe, effective and non-invasive aesthetic procedures for their patients.

Our corporate headquarters and U.S. operations are located in Brisbane, California, where we conduct our manufacturing, research, regulatory, sales, marketing and administrative activities. Outside the United States, we have a direct sales presence in Australia, Canada, France, Germany, Japan, Spain, Switzerland and the United Kingdom. As of September 30, 2006, we had 74 direct sales employees worldwide, a global network of over 30 distributors, and a distributor relationship in the United States with PSS World Medical Shared Services, Inc. ("PSS"), a wholly-owned subsidiary of PSS World Medical. PSS operates medical supply distribution service centers with approximately 700 sales representatives serving physician offices in all 50 of the United States.

Products. Our revenue is derived from the sale of products, product upgrades, amortization of pre-paid service contracts, revenue from out-of-warranty services, and Titan handpiece refills. Product revenue represents the sale of a system console that incorporates a universal graphic user interface, a laser and/ or other light-based module, control system software, high voltage electronics, and one or more handpieces. We offer our customers the ability to select the system that best fits their practice at the time of purchase and then to cost-effectively add applications as their practice grows. This enables customers to upgrade their systems whenever they want and provides us with a source of recurring revenue, which we classify as product upgrade revenue. Service revenue relates to amortization of prepaid maintenance and support contract revenue and receipts for services on out-of-warranty products. Titan handpiece refill revenue is associated with our Titan handpiece, which requires a periodic "refilling" process that includes the replacement of the optical source, after a set number of pulses have been performed.

Significant Business Trends. We believe that our revenue growth has been, and will continue to be, primarily attributable to the following:

- Investments made in our global sales and marketing infrastructure, including the expansion of our sales force to increase our market penetration in an expanding aesthetic laser market.
- Continuing introduction of new aesthetic products and applications.
- Marketing to physicians outside the core dermatologist and plastic surgeon specialties, including the medi-spa market.

During the three months ended September 30, 2006, compared to the same period in 2005, our International net revenue grew by 70%, while our U.S. revenue grew by 20%. The stronger International revenue growth was primarily attributable to significant growth coming from Canada, Japan, and Switzerland. The growth in revenue from Switzerland is primarily attributable to the setting up of our European hub office there in July 2005, from where we also coordinate our European marketing and service activities. For the three months ending December 31, 2006, we expect revenue to be approximately $30.0 million, which will result in the full-year ending December 31, 2006 revenue of over $100 million and an annual growth rate of 33%.

Our gross margin for the nine months ended September 30, 2006 was 69%, compared to 74% for the nine months ended September 30, 2005. This decrease was primarily attributable to $2.0 million, or 3% of net revenue, of royalty expense resulting from the Palomar patent licensing agreement with effect from April 1, 2006- see Note 9 of Notes to Condensed Consolidated Financial Statements—"Litigation Settlement." Further, the decrease in margins was attributable to $1.1 million, or 2% of net revenue, of higher warranty-related expenses. We expect our margins to remain in the 68%-70% range for the quarter ending December 31, 2006.

We settled our patent litigation with Palomar in June 2006. As a consequence of preparing for and settling this litigation, our general and administrative expenses were significantly higher in the first half of 2006, compared with the same period in 2005. With the litigation matter settled, we expect our general and administrative expenses to be in the range of 10-12% of revenue in the fourth quarter ending December 31, 2006.

Factors that May Impact Future Performance. Our industry is impacted by numerous competitive, regulatory and other significant factors. The growth of our business relies on our ability to continue to develop new products and innovative technologies, obtain regulatory clearances and compliance for our products, protect the proprietary technology of our products and our manufacturing processes, manufacture our products cost-effectively, and successfully market and distribute our products in a profitable manner. Our industry is subject to extensive government regulation, including the regulation by the United States Food and Drug Administration. Failure to comply with regulatory requirements could have a material adverse effect on our business. Additionally, our industry is highly competitive and our success depends on our ability to compete successfully. A detailed discussion of these and other factors that could impact our future performance are provided in Part II, Item 1A—"Risk Factors" section.

Critical Accounting Policies and Estimates

The accounting policies that we consider to be critical, subjective, or requiring complex judgments in their application are summarized in *"Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations"* in our Annual Report on Form 10-K for the year ended December 31, 2005 filed with the SEC on March 16, 2006. Other than the adoption of SFAS 123(R), there have been no significant changes during the nine months ended September 30, 2006 to the items that we disclosed as our critical accounting policies and estimates in our Annual Report on Form 10-K for the year ended December 31, 2005.

Stock-Based Compensation Expense

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS 123(R), using the modified prospective transition method, and therefore have not restated prior periods' results. Under this method we recognize compensation expense for all stock-based payments granted after January 1, 2006, and prior to but not yet vested as of January 1, 2006, in accordance with SFAS 123(R). Under the fair value recognition provisions of SFAS 123(R), we recognize stock-based compensation net of an estimated forfeiture rate and only recognize compensation cost for those shares expected to vest on a straight-line basis over the requisite service period of the award. Prior to SFAS 123(R) adoption, we accounted for stock-based payments under APB 25 and accordingly, recognized compensation expense for options that were granted at an exercise price below their deemed fair market value and for restricted stock units granted to employees.

Determining the appropriate fair value model and calculating the fair value of stock-based payment awards require the input of various highly-subjective assumptions, including the expected life of the stock-based payment awards, our stock price volatility and the expected forfeiture rate of our options. Management determined the expected stock price volatility assumption based on a combination of the Company's historical volatility combined with the weighted average of the volatility of other similar companies in the same industry. With effect from April 2006, the expected stock price volatility was based on a combination of the Company's historical volatility combined with the implied volatility of the Company's quoted stock options. We believe these methods of computing volatility are more reflective and a better indicator of the expected future volatility, than using an average of a comparable market index or of a comparable company in the same industry. The expected term of options granted in the nine months ended September 30, 2006, was based on the Company's historical exercise behavior for ten year term options. For five and seven year term options, that the Company started granting in the second quarter of 2006, the expected term was derived from the short-cut method described in SEC's SAB No. 107. The risk-free rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The assumptions used in calculating the fair value of stock-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be significantly different from what we have recorded in the current period. See Note 1 and 2 to the Condensed Consolidated Financial Statements for a further discussion on stock-based compensation.

Recent Accounting Pronouncements

In September 2006, the SEC issued SAB No. 108 regarding the process of quantifying financial statement misstatements. SAB No. 108 states that registrants should use both a balance sheet approach and an income statement approach when quantifying and evaluating the materiality of a misstatement. The interpretations in SAB No. 108 contain guidance on correcting errors under the dual approach as well as provide transition guidance for correcting errors. This interpretation does not change the requirements within SFAS No. 154, "Accounting Changes and Error Corrections- a replacement of APB No. 20 and Financial Accounting Standards Board ("FASB") Statement No. 3," for the correction of an error on financial statements. SAB No. 108 is effective for annual financial statements covering the first fiscal years ending after November 15, 2006. We will be required to adopt this interpretation by December 31, 2006. We are currently evaluating the requirements of SAB No. 108 and the impact this interpretation may have on our financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This standard defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America, and expands disclosure about fair value measurements. This pronouncement applies under other accounting standards that require or permit fair value measurements. Accordingly, this statement does not require any new fair value measurement. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We will be required to adopt SFAS No. 157 in the first quarter of fiscal year 2008. We are currently evaluating the requirements of SFAS No. 157 and have not yet determined the impact on the consolidated financial statements.

In July 2006, FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" effective for fiscal years beginning after December 15, 2006. The Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting for interim periods, disclosure, and transition. We will decide on a policy for interest and penalty classification by the end of 2006 and adopt the Interpretation beginning with the fiscal year ending 2007. Upon adoption, it is not expected that the Interpretation will have a material effect on our financial position or results of operations.

Table of Contents

Results of Operations

The following table sets forth selected consolidated financial data for the periods indicated, expressed as a percentage of net revenue:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Consolidated Statement of Operations:				
Revenue Mix By Geography:				
United States customers	69%	76%	69%	70%
International customers	31%	24%	31%	30%
	100%	100%	100%	100%
Revenue Mix By Product:				
Products	83%	85%	84%	84%
Product upgrades	6%	7%	6%	9%
Service	7%	5%	6%	5%
Handpiece refills	4%	3%	4%	2%
	100%	100%	100%	100%
Operating Ratios:				
Net revenue	100%	100%	100%	100%
Cost of revenue	32%	25%	31%	26%
Gross profit	68%	75%	69%	74%
Operating expenses:				
Sales and marketing	32%	33%	36%	34%
Research and development	7%	7%	6%	8%
General and administrative	12%	10%	16%	13%
Litigation settlement	2%	0%	27%	0%
Total operating expenses	53%	50%	85%	55%
Income (loss) from operations	15%	25%	(16)%	19%
Interest and other income, net	3%	3%	4%	2%
Income (loss) before income taxes	18%	28%	(12)%	21%
Provision (benefit) for income taxes	6%	8%	(5)%	6%
Net income (loss)	12%	20%	(7)%	15%

Three and nine months ended September 30, 2006 and September 30, 2005

Net Revenue

Revenue is derived from the sale of products; product upgrades; amortization of prepaid service contracts and revenue from out-of-warranty services; and Titan handpiece refills. For the three months ended September 30, 2006, compared to the same period in 2005, net revenue increased by $6.1 million, or 32%, from $19.0 million to $25.1 million. This was the result of a $4.7 million, or 29%, increase in product revenue and $279,000, or 21%, increase in upgrade revenue, due to increased advertising and promotional activities and the direct sales force expansion that was made in the second half of 2005. Service revenue increased by $549,000, or 52%, due primarily to an increase in the number of customers purchasing extended service contracts. Revenue from Titan handpiece refills increased by $539,000, or 112%, due to the increased consumer demand for Titan procedures and the fact that the Titan handpiece requires periodic refilling after a set number of pulses have been delivered.

For the nine months ended September 30, 2006, compared to the same period in 2005, net revenue increased by $18.5 million, or 36%, from $51.7 million to $70.2 million. This was the result of a $15.3 million, or 35%, increase in product revenue due to increased advertising and promotional activities and the direct sales force expansion that was made in the second half of 2005. Service revenue for the nine months ended September 30, 2006, compared to the nine months ended September 30, 2005, increased by $1.5 million, or 55%, due primarily to an increase in the number of customers purchasing extended service contracts. For the nine months ended September 30, 2006, compared to the nine months ended September 30, 2005, revenue from Titan handpiece refills increased by $2.0 million, or 199%, due to the increased consumer demand for Titan procedures and the fact that the Titan handpiece requires periodic refilling after a set number of pulses have been delivered. These increases were partially offset by a decline in upgrade revenue, which for the nine months ended September 30, 2006, when compared to the same period in 2005, decreased $277,000 or 6%. This was primarily due to an increase in the number of customers choosing to purchase new systems from our Solera family of products, instead of upgrading their existing systems.

For the three months ended September 30, 2006, compared to the same period in 2005, the geographical source of the $6.1 million increase in net revenue was attributable to $2.9 million in higher U.S. revenue and $3.2 million to higher international revenue. The primary contributors to this revenue growth were the continued expansion of our direct sales force, both domestic and international. For the nine months ended September 30, 2006, compared to the same period in 2005, the geographical source of the $18.5 million increase in net revenue was attributable to $12.5 million in higher U.S. revenue and $6.0 million to higher international revenue. For the three months ending December 31, 2006, we expect revenue to be approximately $30.0 million.

Cost of Revenue

Our cost of revenue consists primarily of material, labor, employee stock-based compensation, royalty expense effective April 1, 2006, warranty, and manufacturing overhead expenses. For the three months ended September 30, 2006, compared to the three months ended September 30, 2005, cost of revenue increased by $3.2 million, or 67%, from $4.7 million to $7.9 million. Cost of revenue as a percentage of revenue, increased from 25% for the three months ended September 30, 2005, to 32% for the three months ended September 30, 2006. This increase in cost of revenue as a percentage of net revenue, was primarily attributable to royalty expense of $1.0 million, or 4% of net revenue, that resulted from the patent licensing agreement entered in June 2006 and discussed in greater detail in Note 9 of Notes to Condensed Consolidated Financial Statements—"Litigation Settlement;" a $477,000, or 2% of net revenue, increase in warranty costs resulting from higher material expenses; and $130,000, or 1% of net revenue, increase in stock-based compensation expense resulting from implementing FAS123(R) with effect from January 1, 2006.

For the nine months ended September 30, 2006, cost of revenue increased by $7.9 million, or 58%, from $13.6 million to $21.5 million. Cost of revenue as a percentage

of revenue, increased from 26% for the nine months ended September 30, 2005, to 31% for the nine months ended September 30, 2006. This increase was primarily attributable to $2.0 million, or 3% of net revenue, of royalty expense resulting from the patent licensing agreement with effect from April 1, 2006- see Note 9 of Notes to Condensed Consolidated Financial Statements—"Litigation Settlement;" and $1.1 million, or 2% of net revenue, due to an increase in warranty costs resulting from higher material expenses. We expect our margins to remain in the 68%-70% range for the three months ending December 31, 2006.

Sales and Marketing

Sales and marketing expenses consist primarily of personnel cost, including costs associated with employee stock-based compensation, and expenses associated with customer-attended workshops, trade shows and advertising. For the three months ended September 30, 2006, compared to the same period in 2005, sales and marketing expenses increased by $2.0 million, or 31%, from $6.2 million to $8.2 million. This increase was primarily attributable to $824,000 of higher personnel expenses and $274,00 higher travel expenses, associated primarily with the higher headcount; $156,000 in higher advertising and promotion expenses due to increased marketing activity; and $336,000 of higher employee stock-based compensation expenses resulting from the adoption of SFAS 123(R) effective January 1, 2006. As a percentage of net revenue, sales and marketing expenses were 32% and 33% for the three months ended September 30, 2006 and 2005, respectively.

For the nine months ended September 30, 2006, compared to the same period in 2005, sales and marketing expenses increased by $7.2 million, or 40%, from $17.8 million to $25.0 million. This increase was primarily attributable to $3.4 million of higher personnel expenses and $776,000 higher travel expenses, associated primarily with the higher headcount; $1.3 million in higher advertising and promotion expenses due to increased marketing activities; and $925,000 of higher employee stock-based compensation expenses resulting from the adoption of SFAS 123(R). As a percentage of net revenue, sales and marketing expenses increased from 34% in the nine months ended September 30, 2005, to 36% in the nine months ended September 30, 2006. This increase was primarily attributable to an increase in world wide direct sales headcount, increased marketing related activities and higher stock-based compensation expense. For the three months ending December 31, 2006, we estimate that sales and marketing expenses will be in the range of 29-31% of net revenue.

Research and Development

Research and development expenses consist primarily of personnel cost, including costs associated with employee stock-based compensation, clinical, regulatory and material costs. For the three months ended September 30, 2006, compared to the three months ended September 30, 2005, research and development expenses increased by $345,000, or 26%, from $1.3 million to $1.7 million. This increase was primarily attributable to $159,000 of higher personnel expenses associated primarily with higher headcount; $129,000 of higher stock-based compensation expense resulting from the adoption of SFAS 123(R) effective January 1, 2006; offset by a decrease in outside service costs by $67,000. As a percentage of net revenue, research and development expenses were 7% in the three months ended September 30, 2006 and 2005.

For the nine months ended September 30, 2006, compared to the nine months ended September 30, 2005, research and development expenses increased by $606,000, or 15%, from $3.9 million to $4.5 million. This increase was primarily attributable to $460,000 of higher personnel expense, due partly to increased headcount; $308,000 of higher stock-based compensation expense resulting from the adoption of SFAS 123(R); which was offset by a decrease in outside service costs of $247,000. As a percentage of net revenue, research and development expenses decreased from 8% in the nine months ended September 30, 2005, to 6% in the nine months ended September 30, 2006. This was primarily due to the higher net revenue in the nine months ended September 30, 2006 period, compared to the same period in 2005. For the three months ending December 31, 2006, we estimate that research and development expenses will be in the range of 6-7% of net revenue.

General and Administrative

General and administrative expenses consist primarily of personnel costs, including costs associated with employee stock-based compensation, legal and accounting fees and other general and administrative expenses. For the three months ended September 30, 2006, compared to the same period in 2005, general and administrative expenses increased by $1.1 million, or 56%, from $1.9 million to $3.0 million. This increase was primarily attributable to $199,000 increase in outside accounting, tax and audit fees, $158,000 increase in personnel expenses due to higher headcount, and $165,000 of higher stock-based compensation expense resulting from the adoption of SFAS 123(R) effective January 1, 2006. As a percentage of net revenue, general and administrative expenses increased from 10%, for the three months ended September 30, 2005, to 12% for the three months ended September 30, 2006.

For the nine months ended September 30, 2006, compared to the same period in 2005, general and administrative expenses increased by $5.1 million, or 78%, from $6.5 million to $11.6 million. This increase was primarily attributable to $2.7 million of higher legal expenses- due primarily to the patent litigation which was settled in June 2006; $732,000 of higher personnel expenses due to higher headcount; and $386,000 of higher stock-based compensation expense resulting from the adoption of SFAS 123(R) with effect from January 1, 2006. As a percentage of net revenue, general and administrative expenses increased from 13%, for the nine months ended September 30, 2005, to 16% for the nine months ended September 30, 2006. With the litigation matter settled, we expect our general and administrative expenses to be in the range of 10-12% of revenue in the fourth quarter ending December 31, 2006.

Litigation Settlement

On June 2, 2006, we settled all patent litigation brought against us by Palomar and MGH. Under the terms of the settlement agreement, we agreed to pay Palomar royalties on past sales of infringing systems, plus accrued interest and reimbursement of Palomar's legal costs through March 31, 2006. During the quarter ended June 30, 2006, we completed a calculation of the actual amounts owed to Palomar through March 31, 2006 and estimated the amount due to be $19.6 million. In the quarter ended September 30, 2006, after further discussions with Palomar, we revised our estimate of the total amount owed to Palomar through March 31, 2006 to $20.2 million.

Of the $20.2 million settlement amount, we recorded $18.9 million that related to past royalties, interest and settlement costs, as a litigation settlement expense for the nine months ended September 30, 2006. The remaining $1.2 million was allocated to the value of the license agreement obtained and recorded as an intangible asset. See Note 9 of Notes to Condensed Consolidated Financial Statements for further details and accounting of the settlement agreement.

Interest and Other Income, Net

For the three and nine months ended September 30, 2006, compared to the same period in 2005, interest and other income increased by $280,000 and $1.3 million, respectively. This increase was primarily attributable to higher tax-exempt interest income from higher yields and an increase in the average cash and marketable investments balance.

Provision (Benefit) for Income Taxes

The interim effective income tax rate is based on management's best estimate of the annual effective income tax rate. The effective tax rate for the three and nine months ended September 30, 2006, was 35% and 43%, respectively. Applying these effective tax rates to our income before income taxes for the quarter and nine month ended September 30, 2006, resulted in a tax provision of $1.6 million and tax benefit of $3.8 million, respectively. For both the three and nine months ended September 30, 2005, our effective income tax rate was 28%. The higher effective tax rate for the three and nine months ended September 30, 2006, compared to the same period in 2005, was primarily due to the impact of the litigation settlement expense being included at the marginal tax rate of 39.28%; the expiration of the law relating to the granting of federal research and development credits in 2006; and because we have fully utilized the benefit from disqualifying dispositions of incentive stock options that can reduce our effective tax rate. For the three months ending December 31, 2006, we expect our effective income tax rate to be approximately 33%.

Liquidity and Capital Resources

As of September 30, 2006, we had cash, cash equivalents and marketable investments of $90.7 million, which we believe are sufficient to meet anticipated cash needs for working capital and capital expenditures for at least the next 12 months. For the nine months ended September 30, 2006 and 2005, our cash flows and contractual obligations are summarized below.

Net Cash Provided by (Used in) Operating Activities

For the nine months ended September 30, 2006, net cash used in operations was $2.1 million. This was primarily attributable to a net loss of $5.0 million; an increase in the deferred tax asset by $3.7 million resulting from the income tax loss carry forward; and cash used to finance an increase in accounts receivable by $2.6 million due to higher revenue. These uses of cash were offset by the adjustment for non-cash stock-based compensation expenses of $3.2 million; cash provided by an increase in accrued liabilities of $3.4 million, due to $1.1 million higher warranty reserve and higher sales and marketing accruals associated with the higher revenue; and cash generated by a $2.2 million increase in deferred revenue associated with a larger number of customers purchasing extended service contracts.

For the nine months ended September 30, 2005, net cash provided by operations was $12.8 million. This was primarily attributable to net income of $8.0 million; cash provided from tax benefits related to employee stock option exercises of $3.1 million; adjustment for non-cash stock-based compensation expenses of $1.2 million; and a reduction of accounts receivable by $1.6 million due to collections of the cyclically high revenue generated in December 2004. This was offset by cash used to increase inventories by $2.4 million for anticipated shipments and a broader product offering; and an increase in other assets of $1.6 million due primarily to prepaid income taxes.

Net Cash Used In Investing Activities

For the nine months ended September 30, 2006, net cash used in investing activities was $2.5 million. Of this amount, $1.2 million was used for the acquisition of the Palomar patent license; $811,000, net, was used to purchase marketable investments with the increase in cash and cash equivalent balance; and $441,000 was used to purchase additional property and equipment primarily for research, development and manufacturing operations.

For the nine months ended September 30, 2005, net cash used in investing activities was $18.9 million. Of this amount, $18.3 million, net, was used to purchase additional marketable investments with the increase in cash and cash equivalent balance, and $579,000 was used to purchase property, equipment and intangibles partly associated with the set up of a new office in Zurich, Switzerland through the acquisition of a distributor.

Net Cash Provided by Financing Activities

For the nine months ended September 30, 2006 and 2005, net cash provided by financing activities was $2.4 million and $3.7 million, respectively. This was attributable to proceeds from the issuance of stock through our stock option and employee stock purchase plans.

Contractual Cash Obligations

The following table discloses aggregate information about our contractual obligations for minimum lease payments related to facility leases and the periods in which these payments are due as of September 30, 2006.

	Payments Due by Period (in thousands)				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Operating leases	$8,556	$ 1,009	$1,872	$2,378	$ 3,297

Off-Balance Sheet Arrangements

We do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, variable interest or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of September 30, 2006, we were not involved in any unconsolidated transactions.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to interest rate risk relates primarily to our investment portfolio. Fixed rate securities may have their fair market value adversely impacted due to fluctuations in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectation due to changes in interest rates or we may suffer losses in principal if forced to sell securities which have declined in market value due to changes in interest rates. The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we invest in debt instruments of the U.S. Government and its agencies, municipal bonds and high-quality corporate issuers, and, by policy, restrict our exposure to any single corporate issuer by imposing concentration limits. To minimize the exposure due to adverse shifts in interest rates, we maintain investments at a weighted average maturity (interest reset date for auction-rate securities and variable rate demand notes) of generally less than eighteen months. Assuming a hypothetical increase in interest rates of one percentage point, the fair value of our total investment portfolio as of September 30, 2006 would have potentially declined by $464,000.

We have international subsidiaries and operations and are, therefore, subject to foreign currency rate exposure. To date, our exposure to exchange rate volatility has not been significant partly due to our sales and operating expenses being predominantly denominated in foreign currencies and we do not maintain significant foreign currency cash balances. We cannot assure that there will not be a material impact in the future. Although the majority of our sales and purchases are denominated in U.S. dollars, future fluctuations in the value of the U.S. dollar may affect the price competitiveness of our products. We do not believe, however, that we currently have significant direct foreign currency exchange rate risk and therefore have not hedged exposures denominated in foreign currencies.

We do not utilize derivative financial instruments, derivative commodity instruments or other market risk sensitive instruments, positions or transactions.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. Our management evaluated, with the participation of the Chief Executive Officer and the Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are

required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosures.

Inherent Limitations on the Effectiveness of Controls. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Changes in Internal Control over Financial Reporting. There was no change in our internal control over financial reporting that occurred during the nine months ended September 30, 2006 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

We are not a party to any material pending litigation.

ITEM 1A. RISK FACTORS

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

Our products compete against similar products offered by public companies, such as Candela, Cynosure, Laserscope- now part of American Medical Systems, Lumenis, Palomar, and Syneron as well as private companies such as Reliant Technologies and Thermage. Competition with these companies could result in price-cutting, reduced profit margins and loss of market share, any of which would harm our business, financial condition and results of operations. We also face competition from medical products, such as Botox, an injectable compound used to reduce wrinkles, and collagen injections. Other alternatives to the use of our products include sclerotherapy, a procedure involving the injection of a solution into the vein to collapse it, electrolysis, a procedure involving the application of electric current to eliminate hair follicles, and chemical peels. We may also face competition from manufacturers of pharmaceutical and other products that have not yet been developed. Our ability to compete effectively depends upon our ability to distinguish our company and our products from our competitors and their products, and includes such factors as:

- intellectual property protection;
- product performance;
- product pricing;
- quality of customer support;
- success and timing of new product development and introductions; and
- development of successful distribution channels, both domestically and internationally.

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

In addition, some of our current and potential competitors have significantly greater financial, research and development, manufacturing, and sales and marketing resources than we have. Our competitors could utilize their greater financial resources to acquire other companies to gain enhanced name recognition and market share, as well as new technologies or products that could effectively compete with our existing product lines. For example, ESC Medical purchased Coherent's medical business in 2001 and the surviving company, Lumenis, incorporated competitive product lines and technologies of the predecessor companies into its current products. Given the relatively few competitors currently in the market, any business combination could exacerbate any existing competitive pressures, which could harm our business.

Competition among providers of laser and other light-based devices for the aesthetic market is characterized by rapid innovation, and we must continuously develop new products or our revenues may decline.

While we attempt to protect our products through patents and other intellectual property, there are few barriers to entry that would prevent new entrants or existing competitors from developing products that compete directly with ours. For example, while our CoolGlide product was the first long-pulse Nd:YAG, or long wavelength, laser system cleared by the FDA for permanent hair reduction on all skin types, competitors have subsequently introduced systems that utilize Nd:YAG lasers, and received FDA clearances to market these products as treating all skin types. We expect that any competitive advantage we may enjoy from other current and future innovations, such as combining multiple handpieces in a single system to perform a variety of applications, may diminish over time, as companies successfully respond to our, or create their own, innovations. Consequently, we believe that we will have to continuously innovate and improve our products and technology to compete successfully. If we are unable to innovate successfully, our products could become obsolete and our revenue will decline as our customers purchase our competitors' products.

Our ability to compete depends upon our ability to innovate, to develop and commercialize new products and product enhancements, and to identify new markets for our technology.

We have created products to apply our technology to hair removal, treatment of veins, skin rejuvenation, treatment of pigmented lesions and treatment of wrinkles. Currently, these applications represent the majority of laser and other light-based aesthetic procedures. To be successful in the future, we must develop new and innovative applications of laser and other light-based technology, identify new markets for our existing technology, and develop new technology that is not light-based. To successfully expand our product offerings, we must:

- develop or acquire new products that either add to or significantly improve our current products;
- convince our target customers that our new products or product upgrades would be an attractive revenue-generating addition to their practices;
- sell our products to non-traditional customers;

- identify new markets and alternative applications for our technology;
- protect our existing and future products with defensible intellectual property; and
- satisfy and maintain all regulatory requirements for commercialization.

Every year since 2000, we have introduced at least one new product and a corresponding upgrade to our existing products. Historically, these introductions have been a significant component of our financial performance. Our business strategy is based, in part, on our expectation that we will continue to make annual product introductions that we can sell to new customers and to existing customers as upgrades. For the quarter ending December 31, 2006, we plan to invest approximately 6-7% of net revenue in our research and development department. Even with a significant investment in research and development, we may be unable, however, to continue to develop new products and technologies annually, or at all, which could adversely affect our projected growth rate.

If PSS World Medical fails to perform to our expectations, we may fail to achieve anticipated operating results.

We have a distribution agreement with PSS World Medical Shared Services, Inc. ("PSS"), a wholly-owned subsidiary of PSS World Medical, , which operates medical supply distribution service centers with approximately 700 sales representatives serving physician offices in all 50 states of the United States. PSS sales representatives work in coordination with our sales force to locate new potential customers for our products. For the year ended December 31, 2005 and for the nine months ended September 30, 2006, approximately 16% of our revenue came from PSS.

If PSS does not perform adequately under the arrangement, or terminates our relationship, which it can do at any time upon 180 days notice, it may have a material adverse effect on our business, financial condition, results of operations or future cash flows.

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

We provide guidance to the investing community regarding our anticipated future operating performance, both for the coming quarter and fiscal year-end. Our business typically has a short sales cycle, we do not have significant backlog of orders at the start of a quarter, and our ability to sell our products successfully is subject to many uncertainties, as discussed herein. In light of those factors, it is difficult for us to estimate with accuracy our future results. In the past, our actual performance had turned out to be significantly different from our prior guidance. For example, at the beginning of 2005, we indicated that we expected our 2005 revenue to increase by 25% over 2004. Actual 2005 growth was higher, at 44% over 2004. Earlier in the year, we stated publicly that we expected our revenue to grow 25% in 2006, compared to 2005 — and we have since revised our guidance for the full year of 2006 to 33%. As we stated at the time, such expectations are subject to numerous risks and uncertainties which could make actual results differ materially, either higher or lower. If our actual results do not meet our public guidance, or our results or guidance as to the future were to be below the expectations of third party financial analysts, our stock price could decline significantly.

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

We recently settled costly patent litigation with Palomar—see Note 9 of Notes to Condensed Consolidated Financial Statements—"Litigation Settlement." As with that case, our competitors or other patent holders may assert that our products and the methods we employ are covered by their patents. In addition, we do not know whether our competitors will apply for and obtain patents that will prevent, limit or interfere with our ability to make, use, sell or import our products. Although we may seek to resolve any potential future claims or actions, we may not be able to do so on reasonable terms, or at all. If, following a successful third-party action for infringement, we cannot obtain a license or redesign our products, we may have to stop manufacturing and marketing our products and our business would suffer as a result.

We may become involved in litigation not only as a result of alleged infringement of a third party's intellectual property rights but also to protect our own intellectual property. For example, we have been, and may hereafter become, involved in litigation to protect the trademark rights associated with our company name or the names of our products. Infringement and other intellectual property claims, with or without merit, can be expensive and time-consuming to litigate, and could divert management's attention from our core business. We do not know whether necessary licenses would be available to us on satisfactory terms, or whether we could redesign our products or processes to avoid infringement. If we lose this kind of litigation, a court could require us to pay substantial damages, and prohibit us from using technologies essential to our products, any of which would have a material adverse effect on our business, results of operations and financial condition.

Our patent litigation settlement payment to Palomar is subject to audit, which could result in a material adverse effect on our business and our stock price.

On June 2, 2006, we settled our patent litigation with Palomar and MGH - with Palomar granting us an irrevocable license to the subject patents. Under the terms of the settlement agreement, we made a good faith estimated payment to Palomar of $22.0 million, representing our estimate of royalties due on past sales of the infringing systems, plus accrued interest and reimbursement of Palomar's legal costs through March 31, 2006. The actual amounts owed to Palomar through March 31, 2006 are subject to review by an independent public accountant hired by Palomar. This audit is expected to be completed by December 31, 2006.

Subsequent to the date of the settlement, the Company completed a calculation of the actual amounts owed to Palomar through March 31, 2006 and estimated the amount due to be $19.6 million. During the quarter ended September 30, 2006, after further discussions with Palomar, we revised our estimate of the total amount owed to Palomar through March 31, 2006 to $20.2 million. This liability was calculated based on our interpretation of the settlement agreement and our historical records of the underlying transactions that are subject to the royalty. The independent public accountant's interpretation of the applicable royalty rate for our different product and transaction types, and the net revenue for which to calculate the royalty, could be different from ours. In the event that the independent public accountant's assessment of the accuracy of our final settlement amount owed by us to Palomar is materially different from our calculations, we could owe a higher settlement amount to Palomar that would then have to be reported as an additional expense in our financial statements for the year ending on December 31, 2006. This could result in a material adverse effect on our business and stock price.

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

We rely on patent, copyright, trade secret and trademark laws and confidentiality agreements to protect our technology and products. At September 30, 2006, we had seven issued U.S. patents, some covering our ClearView handpiece design and cooling method. Some of our other components, such as our laser module, electronic control system and high-voltage electronics, are not, and in the future may not be, protected by patents. Additionally, our patent applications may not issue as patents or, if issued, may not issue in a form that will be advantageous to us. Any patents we obtain may be challenged, invalidated or legally circumvented by third parties. Consequently, competitors could market products and use manufacturing processes that are substantially similar to, or superior to, ours. We may not be able to prevent the unauthorized disclosure or use of our technical knowledge or other trade secrets by consultants, vendors, former employees or current employees, despite the existence generally of confidentiality agreements and other contractual restrictions. Monitoring unauthorized uses and disclosures of our intellectual property is difficult, and we do not know whether the steps we have taken to protect our intellectual property will be effective. Moreover, the laws of many foreign countries will not protect our intellectual property rights to the same extent as the laws of the United States.

The absence of complete intellectual property protection exposes us to a greater risk of direct competition. Competitors could purchase one of our products and attempt to replicate some or all of the competitive advantages we derive from our development efforts, design around our protected technology, or develop their

own competitive technologies that fall outside of our intellectual property rights. If our intellectual property is not adequately protected against competitors' products and methods, our competitive position could be adversely affected, as could our business.

If we fail to obtain clearance from the U.S. Food and Drug Administration to market our Titan product for additional indications, our revenue from this product

may be adversely affected.

Our Titan product, introduced in 2004, is a material component of our growth strategy. We currently have FDA clearance to market Titan in the United States for deep dermal heating. The FDA has denied our initial 510(k) application to market Titan for wrinkle reduction on the basis that Titan is not substantially equivalent to predicate devices for the treatment of wrinkles. We are continuing to seek a clearance from the FDA to market Titan for additional indications, but there are no assurances as to when, or whether, we will ever obtain such a clearance. We cannot promote or advertise our Titan product in the United States for any indications other than deep dermal heating until we receive additional FDA clearances. In the event that we do not obtain additional FDA clearances, our ability to market Titan in the United States and revenue derived therefrom, including revenue from both Titan unit sales and handpiece refills, may be adversely affected.

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

Our products are medical devices that are subject to extensive regulation in the United States by the FDA for manufacturing, labeling, sale, promotion, distribution and shipping. Before a new medical device, or a new use of or labeling claim for an existing product, can be marketed in the United States, it must first receive either 510(k) clearance or pre-marketing approval from the FDA, unless an exemption applies. Either process can be expensive and lengthy. In the event that we do not obtain additional FDA clearances, our ability to market future products or applications in the United States and revenue derived therefrom may be adversely affected.

Medical devices may be marketed only for the indications for which they are approved or cleared and if we are found to be marketing our products for off-label, or non-approved, uses we might be subject to FDA enforcement action or have other resulting liability. We have obtained 510(k) clearance for the indications for which we market our products. However, our clearances can be revoked if safety or effectiveness problems develop. We also are subject to Medical Device Reporting regulations, which require us to report to the FDA if our products cause or contribute to a death or serious injury, or malfunction in a way that would likely cause or contribute to a death or serious injury. Our products are also subject to state regulations, which are, in many instances, in flux. Changes in state regulations may impede sales. For example, federal regulations allow our products to be sold to, or on the order of, “licensed practitioners,” as determined on a state-by-state basis. As a result, in some states, non-physicians may legally purchase our products. However, a state could change its regulations at any time, thereby disallowing sales to particular types of end users. We cannot predict the impact or effect of future legislation or regulations at the federal or state levels.

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

- warning letters, fines, injunctions, consent decrees and civil penalties;
- repair, replacement, refunds, recall or seizure of our products;
- operating restrictions or partial suspension or total shutdown of production;
- refusing our requests for 510(k) clearance or pre-market approval of new products, new intended uses, or modifications to existing products;
- withdrawing 510(k) clearance or pre-market approvals that have already been granted; and
- criminal prosecution.

If any of these events were to occur, they could harm our business.

If we fail to comply with the FDA’s Quality System Regulation and laser performance standards, our manufacturing operations could be halted, and our business would suffer.

We are currently required to demonstrate and maintain compliance with the FDA’s Quality System Regulation, or QSR. The QSR is a complex regulatory scheme that covers the methods and documentation of the design, testing, control, manufacturing, labeling, quality assurance, packaging, storage and shipping of our products. Because our products involve the use of lasers, our products also are covered by a performance standard for lasers set forth in FDA regulations. The laser performance standard imposes specific record-keeping, reporting, product testing and product labeling requirements. These requirements include affixing warning labels to laser products, as well as incorporating certain safety features in the design of laser products. The FDA enforces the QSR and laser performance standards through periodic unannounced inspections. We have been, and anticipate in the future to be, subject to such inspections. Our failure to take satisfactory corrective action in response to an adverse QSR inspection or our failure to comply with applicable laser performance standards could result in enforcement actions, including a public warning letter, a shutdown of our manufacturing operations, a recall of our products, civil or criminal penalties, or other sanctions, such as those described in the preceding paragraph, which would cause our sales and business to suffer.

If we modify one of our FDA-approved devices, we may need to seek re-approval, which, if not granted, would prevent us from selling our modified products or cause us to redesign our products.

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

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

Sales of our products outside the United States are subject to foreign regulatory requirements that vary widely from country to country. In addition, exports of medical devices from the United States are regulated by the FDA. Complying with international regulatory requirements can be an expensive and time-consuming process and approval is not certain. The time required to obtain clearance or approvals, if required by other countries, may be longer than that required for FDA clearance or approvals, and requirements for such clearances or approvals may significantly differ from FDA requirements. We may be unable to obtain or maintain regulatory qualifications, clearances or approvals in other countries. We may also incur significant costs in attempting to obtain and in maintaining

foreign regulatory approvals or qualifications. If we experience delays in receiving necessary qualifications, clearances or approvals to market our products outside the United States, or if we fail to receive those qualifications, clearances or approvals, we may be unable to market our products or enhancements in international markets effectively, or at all, which could have a material adverse effect on our business and growth strategy.

To successfully market and sell our products internationally, we must address many issues with which we have little or no experience.

For the nine months ended September 30, 2006, approximately 31% of our revenue was derived from international customers, which are a material component of our growth strategy. We depend on third-party distributors and a relatively new direct sales operation to sell our products internationally, and if these distributors or direct sales personnel under-perform, we may be unable to increase or maintain our level of international revenue. We will need to attract additional international distributors to grow our business and expand the territories in which we sell our products. Distributors may not accept our business or commit the necessary resources to market and sell our products to the level of our expectations. If current or future distributors do not perform adequately, or we are unable to engage distributors in particular geographic areas, we may not realize projected international revenue growth. Additionally, we expect to expand our direct sales force in Europe and Asia. If we are unable to hire, retain and obtain satisfactory performance from such additional personnel, our revenue from international operations may be adversely affected.

We believe that an increasing amount of our future revenue will come from international sales as we expand our overseas operations and develop opportunities in additional international territories. International sales are subject to a number of risks, including:

- difficulties in staffing and managing our foreign operations;
- difficulties in penetrating markets in which our competitors' products are more established;
- reduced protection for intellectual property rights in some countries;
- export restrictions, trade regulations and foreign tax laws;
- fluctuating foreign currency exchange rates;
- foreign certification and regulatory requirements;
- lengthy payment cycles and difficulty in collecting accounts receivable;
- customs clearance and shipping delays;
- political and economic instability;
- lack of awareness of our brand in international markets; and
- preference for locally-produced products.

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

The expense and potential unavailability of insurance coverage for our customers and our company could adversely affect our ability to sell our products and our financial condition.

Some of our customers and prospective customers have had difficulty in procuring or maintaining liability insurance to cover their operation and use of our products. Medical malpractice carriers are withdrawing coverage in certain states or substantially increasing premiums. If this trend continues or worsens, our customers may discontinue using our products and, industry-wide, potential customers may opt against purchasing laser and other light-based products due to the cost of or inability to procure insurance coverage.

We have been experiencing steep increases in our product liability insurance premiums. If our premiums continue to rise, we may no longer be able to afford adequate insurance coverage. If we are unable to maintain adequate coverage, potential product liability claims would be paid out of cash reserves, harming our financial condition, operating results and profitability.

Because we do not require training for users of our products, and sell our products to non-physicians, there exists an increased potential for misuse of our products, which could harm our reputation and our business.

Federal regulations allow us to sell our products to or on the order of "licensed practitioners." The definition of "licensed practitioners" varies from state to state. As a result, our products may be purchased or operated by physicians with varying levels of training, and in many states by non-physicians, including nurse practitioners, chiropractors and technicians. Outside the United States, many jurisdictions do not require specific qualifications or training for purchasers or operators of our products. We do not supervise the procedures performed with our products, nor do we require that direct medical supervision occur. We, and our distributors, generally offer but do not require purchasers or operators of our products to attend training sessions. In addition, we sometimes sell our systems to companies that rent our systems to third parties and that provide a technician to perform the procedure. The lack of training and the purchase and use of our products by non-physicians may result in product misuse and adverse treatment outcomes, which could harm our reputation and expose us to costly product liability litigation.

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

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

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

Many of the components and materials that comprise our products are currently manufactured by a limited number of suppliers. A supply interruption or an increase in demand beyond our current suppliers' capabilities could harm our ability to manufacture our products until a new source of supply is identified and qualified. Our reliance on these suppliers subjects us to a number of risks that could harm our business, including:

- interruption of supply resulting from modifications to or discontinuation of a supplier’s operations;

- delays in product shipments resulting from uncorrected defects, reliability issues or a supplier's variation in a component;
- a lack of long-term supply arrangements for key components with our suppliers;
- inability to obtain adequate supply in a timely manner, or on commercially reasonable terms;
- difficulty locating and qualifying alternative suppliers for our components in a timely manner;
- production delays related to the evaluation and testing of products from alternative suppliers, and corresponding regulatory qualifications;
- delay in delivery due to our suppliers prioritizing other customer orders over ours; and
- fluctuation in delivery by our suppliers due to changes in demand from us or their other customers.

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

Components used in our products are complex in design, and any defects may not be discovered prior to shipment to customers, which could result in warranty obligations, reducing our revenue and increasing our cost.

In manufacturing our products, we depend upon third parties for the supply of various components. Many of these components require a significant degree of technical expertise to produce. If our suppliers fail to produce components to specification, or if the suppliers, or we, use defective materials or workmanship in the manufacturing process, the reliability and performance of our products will be compromised.

If our products contain defects that cannot be repaired easily and inexpensively, we may experience:

- loss of customer orders and delay in order fulfillment;
- damage to our brand reputation;
- increased cost of our warranty program due to product repair or replacement;
- inability to attract new customers;
- diversion of resources from our manufacturing and research and development departments into our service department; and
- legal action.

The occurrence of any one or more of the foregoing could materially harm our business.

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

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

If there is not sufficient demand for the procedures performed with our products, practitioner demand for our products could be inhibited, resulting in unfavorable operating results and reduced growth potential.

Continued expansion of the global market for laser- and other light-based aesthetic procedures is a material assumption of our growth strategy. Most procedures performed using our products are elective procedures not reimbursable through government or private health insurance, with the costs borne by the patient. The decision to utilize our products may therefore be influenced by a number of factors, including:

- the cost of procedures performed using our products;
- the cost, safety and effectiveness of alternative treatments, including treatments which are not based upon laser- or other light-based technologies and treatments which use pharmaceutical products;
- the success of our sales and marketing efforts; and
- consumer confidence, which may be impacted by economic and political conditions.

If, as a result of these factors, there is not sufficient demand for the procedures performed with our products, practitioner demand for our products could be reduced, resulting in unfavorable operating results and lower growth potential.

Lack of demand for our products in the non-core market would harm our anticipated revenue growth.

An increasing portion of our revenue is derived from sales to customers outside of the core dermatologist and plastic surgeon specialties, such as family practitioners, primary care physicians, gynecologists, medi-spas, etc. Continuing to achieve further penetration into this new market is a material assumption of our growth strategy. Demand for our products in the non-core market could be weakened by factors including, poor financial performance of businesses introducing aesthetic procedures to their practice or medi-spas, reduced patient demand for alternative treatments and services being provided by non-core practitioners and an increase in malpractice law suits against non-core practitioners. If we do not achieve anticipated demand for our products in the non-core market, our expected revenue growth may not be achieved.

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

Our success largely depends on the skills, experience and efforts of our officers and other key employees. We do not have employment contracts with any of our officers or other key employees. Any of our officers and other key employees may terminate their employment at any time. We do not have a succession plan in place for any of our officers and key employees. In addition, we do not maintain "key person" life insurance policies covering any of our employees. The loss of any of our senior management team members could weaken our management expertise and harm our business.

Our ability to retain our skilled labor force and our success in attracting and hiring new skilled employees will be a critical factor in determining whether we will be successful in the future. We may not be able to meet our future hiring needs or retain existing personnel. We will face particularly significant challenges and risks in hiring, training, managing and retaining engineering and sales and marketing employees. Failure to attract and retain personnel, particularly technical and sales and marketing personnel, would materially harm our ability to compete effectively and grow our business.

Our financial results will be affected by accounting rules governing the recognition of stock-based compensation expense.

As of January 1, 2006, we adopted SFAS 123(R), which requires us to measure and record stock-based compensation expense using the fair value method, which adversely affects our results of operations by increasing our cost by the amount of such stock-based compensation charges. In the quarter ending December 31, 2006, we estimate that the adoption of FAS 123(R) will increase our cost of goods sold and operating expenses by approximately $1.25 million, before income taxes. However, our estimate of future stock-based compensation expense is affected by our stock price, the number of stock-based awards our board of directors may grant or are forfeited in the fourth quarter ending December 31, 2006, as well as a number of valuation assumptions and the related tax effect.

Determining the appropriate fair value model and calculating the fair value of stock-based payment awards require the input of highly subjective assumptions, including the expected life of the stock-based payment awards, our stock price volatility and the expected forfeiture rate of our options; these assumptions represent management's best estimates, and they involve inherent uncertainties and the application of management judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be significantly different from what we have recorded in the current period.

Failure to maintain effective internal control over financial reporting could have a material adverse effect on our business, operating results and stock price.

Beginning with the annual report for our fiscal year ended on December 31, 2005, Section 404 of the Sarbanes-Oxley Act of 2002 required us to include a report by our management on our internal control over financial reporting. Such report contained an assessment by management of the effectiveness of our internal control over financial reporting as of the end of our fiscal year and a statement as to whether or not such internal control is effective. Also included in our Annual Report on Form 10-K was an opinion by our Independent Registered Public Accounting Firm of management's assessment of such internal control.

Our efforts to comply with Section 404 have resulted in, and are likely to continue to result in, significant costs, the commitment of time and operational resources and the diversion of management's attention. Though management did not identify any material weaknesses in our internal control over financial reporting during the year ended December 31, 2005, if we are unable to assert that our internal control over financial reporting is effective as of our fiscal year end in 2006 and future years, our business may be harmed.

Our effective income tax rate may vary significantly.

Unanticipated changes in our tax rates could affect our future results of operations. Our future effective tax rates could be unfavorably affected by changes in tax laws or the interpretation of tax laws, by unanticipated decreases in the amount of revenue or earnings in countries with low statutory tax rates, by changes in the valuation of our deferred tax assets and liabilities, future levels of research & development spending, deductions for employee stock option exercises being different to what we projected, and changes in overall levels of income before taxes.

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

We expect to evaluate potential strategic acquisitions of complementary businesses, products or technologies. We may also consider joint ventures and other collaborative projects. We may not be able to identify appropriate acquisition candidates or strategic partners, or successfully negotiate, finance or integrate any businesses, products or technologies that we acquire. Furthermore, the integration of any acquisition and management of any collaborative project may divert management's time and resources from our core business and disrupt our operations. We do not have any experience with acquiring companies or products. If we decide to expand our product offerings beyond laser and other light-based products, we may spend time and money on projects that do not increase our revenue.

Any cash acquisition we pursue would diminish our available cash balances to us for other uses, and any stock acquisition would be dilutive to our stockholders. While we from time to time evaluate potential collaborative projects and acquisitions of businesses, products and technologies, and anticipate continuing to make these evaluations, we have no present understandings, commitments or agreements with respect to any acquisitions or collaborative projects.

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

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

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

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

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

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

ITEM 5. OTHER INFORMATION

In accordance with Section 10A(i)(2) of the Securities Exchange Act of 1934, as added by Section 202 of the Sarbanes-Oxley Act of 2002 (the "Act"), we are required to disclose the non-audit services approved by our Audit Committee to be performed by PricewaterhouseCoopers LLP, our Independent Registered Public Accounting Firm. Non-audit services are defined in the Act as services other than those provided in connection with an audit or a review of the financial statements of a company. The Audit Committee has approved the engagement of PricewaterhouseCoopers LLP for the following non-audit services: (1) various tax matter consultations concerning U.S. federal and state taxes and foreign taxes for our expatriates.

ITEM 6. EXHIBITS

Exhibit No.	Description
3.2(1)	Amended and Restated Certificate of Incorporation of the Registrant (Delaware).
3.4(1)	Bylaws of the Registrant.
4.1(2)	Specimen Common Stock certificate of the Registrant.
10.13*	Distribution Agreement between the Registrant and PSS World Medical Shared Services, Inc., a subsidiary of PSS World Medical dated October 1, 2006.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Confidential Treatment has been requested for certain portions of this exhibit.

(1) Incorporated by reference from our Registration Statement on Form S-1 (Registration No. 333-111928) which was declared effective on March 30, 2004.

(2) Incorporated by reference from our Annual Report on Form 10-K filed with the SEC on March 25, 2005.

Table of Contents

SIGNATURE

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

CUTERA, INC.

Date: November 8, 2006

/s/ Ronald J. Santilli

Ronald J. Santilli
Chief Financial Officer
(Principal Financial Officer and
Authorized Signatory)

Exhibit 10.13

DISTRIBUTION AGREEMENT

This Distribution Agreement between PSS WORLD MEDICAL SHARED SERVICES, INC., ("PSS") with its offices at 4345 Southpoint Boulevard, Jacksonville, Florida, 32216, and Cutera, Inc. ("Cutera"), a Delaware corporation, with offices at 3240 Bayshore Blvd., Brisbane, CA. 94005, (the "Parties") is effective this 1st day of October, 2006 ("Effective Date").

WHEREAS Cutera develops, manufactures and markets aesthetic light-based systems and related services.

WHEREAS PSS distributes products and seeks to distribute additional products to its customers; and,

WHEREAS Cutera desires to appoint PSS as an authorized distributor of Cutera products, accessories and related goods and PSS desires to accept such appointment.

THEREFORE PSS agrees to purchase and Cutera agrees to sell such Products upon the following terms and conditions:

1. DEFINITIONS

The following terms have the meaning indicated here when used in this Agreement:

1.1 "Agreement" means this Agreement, together with all Exhibits which are attached hereto or incorporated by reference herein, and which are an integral part of herein.

1.2 "Affiliate": With respect to either party, any person, firm, corporation or other legal entity which controls or is controlled by or under common control with such party.

1.3 "Products": All products, supplies, accessories, parts and related goods listed in Exhibit 1 as well as any and all updates and enhancements of the Products, and any other products that the parties mutually agree to add by a signed writing to Exhibit 1. Notwithstanding any other term in this Agreement, Cutera may from time to time discontinue the manufacture and/or sale of any or all Products, and/or change its service policies, warranties and product designs without any obligation or liability to PSS provided that such discontinuations and/or changes apply to Cutera's customers generally.

1.4 "Territory": The United States.

2. APPOINTMENT

2.1 Appointment: Subject to the terms and conditions of this Agreement, Cutera hereby appoints PSS as its exclusive third party distributor of the Products to licensed physicians ("Physicians") in the Territory, and PSS accepts such appointment. Cutera agrees to sell Products to PSS, and PSS agrees to purchase the same from Cutera only for resale to Physicians for delivery and use within the Territory, under the terms and conditions herein. The 'exclusivity' of this appointment means that Cutera will not appoint any other third-party

distributors to resell Products to Physicians for delivery and use within the Territory. For purposes of the foregoing sentence, an entity that is a beauty-or spa chain or franchise or otherwise an entity that may purchase multiple units of Products for itself and its affiliates will not be deemed a 'distributor.' Notwithstanding any other term in this Agreement, Cutera reserves the right, without any compensation owing to PSS, to market and sell the Products in the Territory through its employees and third-party leasing companies.

2.2 Competitive Products: During the Term of this Agreement, PSS shall not engage, either directly or indirectly, in the manufacture, marketing, promotion or sale of products that are similar to or competitive with the Products covered by this Agreement, unless Cutera and PSS agree in advance in writing.

2.3 Orders

a. PSS will submit purchase orders for the Products from time to time, and each order will be subject to Cutera's acceptance. Each order will specify the types and quantities of requested Products, and the proposed delivery dates and destination points. No other terms or conditions on any PSS order shall be binding on Cutera unless expressly accepted in writing by Cutera. The terms and conditions of this Agreement shall be incorporated into each PSS order. In the event of any conflicts, differences or inconsistencies between the terms and conditions of a PSS purchase order and this Agreement, this shall govern. PSS will provide Cutera with the contact information of each entity that purchases Products from PSS.

b. Delivery dates provided by Cutera are approximate only. Products may be dropped shipped to PSS' customers. PSS may, without any liability to Cutera, cancel an order in whole or in part anytime before original scheduled shipment date; provided that written notice of cancellation must be received by Cutera prior to such date.

c. Title will pass to PSS at Cutera's factory. Products are deemed accepted upon shipment. However, without expanding or modifying the product warranty in Exhibit 2, attached hereto, PSS or PSS customer shall have the opportunity to inspect the Products upon delivery and provide Cutera with written notice of any identified damage or loss.

d. Cutera is responsible for packaging of Products so as to reasonably protect from damage. In addition, Cutera is responsible for selection and payment of freight carrier and insurance. As such, Cutera, on behalf of PSS, is responsible for filing, managing and collecting on all loss and damage claims identified and communicated by PSS to Cutera per section 2.3 c.

3. RELATIONSHIP

3.1 The relationship of PSS to Cutera shall be that of an independent contractor engaged in purchasing Products from Cutera for resale to PSS's customers.

3.2 Nothing contained in this Agreement shall be deemed to create a partnership or joint venture between the Parties. Neither the making nor the performance of this Agreement shall be construed in any manner to have established a joint venture or partnership.

3.3 Neither Party shall hold itself out as the agent of the other, nor shall they incur any indebtedness or obligations in the name of, or which shall be binding on the other, without the prior written consent of the other. Each Party assumes full responsibility for its own personnel under laws and regulations of the governmental authorities of the competent jurisdiction.

3.4 Cutera shall comply, to the extent applicable, with all laws, regulations and orders relating to its performance under this Agreement, including without limitation all anti-fraud and anti-kickback laws, regulations and orders. PSS and Cutera each agrees, warrants and certifies that in performance of this Agreement it will fully comply with the provisions of the Social Security Act, Section 1128B(b) (42 U.S.C. Section 1320a-7b(b)) which prohibit the knowing or willful offer, solicitation or receipt of any remuneration, including discounts and/or rebates, directly or indirectly, in return for purchasing, leasing or ordering, or arranging for or recommending the purchase, lease or order, of any services or items, including any Products, for which payment may be made in whole or in part under a federal health care program. Without limiting the generality of the foregoing, Cutera shall not, directly or indirectly, pay any compensation, amounts, benefits or other consideration to any PSS employee, or any family member of a PSS employee, (other than customary gifts valued under $100 in the course of one year, and business meals in the ordinary course) without the express written consent of PSS.

3.5 Cutera understands that, in an effort to control the flow and content of communications, PSS would prefer that Cutera not send any product or samples of medical, marketing materials or other communications (including without limitation, email, voice mail, direct mail or fax) to a group of more than five of PSS's employees or agents without written consent from PSS. Therefore, Cutera and PSS agree to discuss this matter in good faith if, in the reasonable opinion of either party, it becomes a problem in their relationship

4. TERM OF AGREEMENT

4.1 The term of this Agreement shall commence on the Effective Date and continue indefinitely until either party terminates the same, with or without cause, on one hundred eighty days' written notice, unless sooner terminated by either party pursuant to section 5.1 or 5.2, below.

4.2 In the event of expiration or termination of this Agreement for any reason, this Agreement shall continue to apply to all orders previously accepted by Cutera.

5. TERMINATION

5.1 If either Party breaches or fails to perform any of the material obligations imposed upon it under the terms of this Agreement, the other Party may terminate the Agreement in the event the breaching Party fails to cure such breach within thirty (30) days after receiving written notice of such breach from the non-breaching party.

5.2 To the extent permitted by law, if either Party becomes insolvent, is unable to pay its debts when due, files for bankruptcy, is subject of involuntary bankruptcy, has a receiver appointed, or has its assets assigned, the other Party may terminate this Agreement immediately upon written notice to the other party and may cancel any unfulfilled obligations.

5.3 Either party shall have the right to terminate this Agreement for any reason and without cause by providing written notice to the other party one hundred and eighty (180) days prior to the effective date of such termination. After ninety (90) days following delivery of written notice (1) Cutera may, without owing any compensation to PSS, appoint third parties to market, sell and distribute the products to Physicians in the Territory and (2) PSS can engage, either directly or indirectly, in the manufacture, marketing, promotion or sale of products that are similar to or competitive with the products covered by this Agreement. PSS and Cutera agree to work cooperatively in this transition period.

5.4 Immediately upon the termination of this Agreement, PSS will discontinue holding itself out as an authorized Cutera distributor, and will return all pricelists, catalogs, marketing material and all other sales aids furnished by or through Cutera to PSS.

6. ASSIGNMENT

6.1 During the term of this Agreement, the rights of either party under this Agreement shall not be assigned nor shall the performance of duties hereunder be delegated, without the other party's prior written consent, which shall not be unreasonably withheld; provided however, either party may assign this Agreement (i) to its Affiliate that is such an Affiliate as of date of execution of this Agreement; or, (ii) to its Affiliate whose assets consist entirely of the assets of an Affiliate or Affiliates that were Affiliates of such assigning party as of the date of execution of this Agreement.

6.2 Either party shall have the right to assign this Agreement to a successor to or acquirer of all or substantially all of its assets. Any assignment of this Agreement, whether due to consent by a party, operation of law or Change in Control, shall not relieve the assigning Party of its obligations hereunder.

7. SALES PROCEDURE

7.1 The parties agree to meet, discuss and cooperate in good faith in order to agree on and implement mutually beneficial policies and procedures with respect to the marketing, solicitation and sales of the Products, including without limitation those relating to the identification of leads and prospective customers ("Prospects"), marketing and solicitation activities, and closing of sales to Prospects. In this regard, the Marketing Manager for PSS ("Marketing Manager") and the Vice President of Sales for Cutera shall take the lead in such discussions toward reaching mutual agreement on such details.

7.2 Subject to the specific policies and procedures that are hereafter agreed upon by the parties in writing, the Marketing Manager shall submit the Prospect information to Cutera via email. Cutera will then determine whether the Prospect is currently being actively pursued by Cutera (a "Cutera Prospect"). For purposes of this Agreement, a Prospect will be

considered a “Cutera Prospect” if, for example, Cutera has engaged in bilateral discussions with the Prospect (as opposed to, for example, an unanswered solicitation from Cutera). Cutera shall provide to PSS on a regular basis a current, accurate and complete list of all Cutera Prospects.

i. If the Prospect is a Cutera Prospect, then PSS will not sell, nor attempt to sell, any Products to that Prospect for one hundred and twenty days from the date that Cutera notified PSS that that is a Cutera Prospect. Notwithstanding the foregoing, but subject to the provisions of Section 2.2, nothing herein shall prohibit PSS from calling, communicating with, marketing to or selling non-Cutera Products to Cutera Prospects.

ii. If the Prospect is not a Cutera Prospect, than Cutera will not sell, or attempt to sell, any Products to that Prospect for one hundred twenty days from the date that PSS first identified it to Cutera as a Prospect.

8. PRICES AND PAYMENTS

8.1 Prices which PSS shall pay Cutera for the Products purchased, shall be the prices set forth in Exhibit 1. Prices and all price quotations include the Product, labeling and packaging, freight, duties and insurance. Prices exclude taxes, which are PSS’ responsibility (excluding taxes based on Cutera’s taxable income). Wherever applicable, all such taxes may be added to the invoice or invoiced separately.

8.2 . Notices by Cutera of price decreases will be effective upon delivery, but only with respect to new orders booked after the date such notice was delivered. Notices by Cutera of price increases will be effective 90 days from delivery; i.e., they will be effective on new orders booked after the 90th day following delivery of the notice. All such notices shall be sent to PSS at the following addresses:

Mail:
PSS World Medical Shared Services
Pricing Department
4345 Southpoint Blvd.
Jacksonville, Florida 32216

PSS Marketing Department
Attn: Cutera Marketing Manager
4345 Southpoint Blvd.
Jacksonville, Florida 32216

Email:
psspricing@pssd.com

Facsimile: (904) 332-3452

8.3 Payment Payment terms are fifty (50) days from the date of Cutera’s invoice. Delinquent invoices shall have a late payment charge of the lesser of eighteen percent per year or the maximum legal rate assessed against any unpaid balance from the original due date until the date of payment. Cutera may withhold shipments if PSS is delinquent in making payments or in breach of this Agreement. Until the full purchase price has been received by Cutera, Cutera shall retain a security interest in the Products (and any proceeds thereof) and the right to immediate possession thereof (without prejudice to any other available remedies). PSS shall, from time to time, take all acts requested by Cutera to transfer, create, perfect, preserve and/or enforce this security interest.

8.4 In competitive situations or as part of a large order, PSS and Cutera may agree on a special price arrangement.

8.5 PSS shall set the end user selling prices at the sole judgment of PSS.

8.6 If PSS is not maintaining gross margins of at least ten percent, then the parties will discuss the matter in good faith.

9. SUPPLY CHAIN SERVICE AND PERFORMANCE REQUIREMENTS

9.1 PSS will submit fax or electronic purchase orders to Cutera, and Cutera will respond by fax or e-mail within two business days with a) verification at the item level of shipment date, ship-from location, and shipment mode/carrier, b) order confirmation number, c) price discrepancies, d) backorders and expected backorder release dates, and e) notification of failure to meet minimum order requirements.

9.2 Cutera agrees to ship all orders within fifteen business days, unless otherwise agreed to by the parties.

9.3 Cutera will use commercially reasonable efforts to install and complete customer training for the Product(s) within thirty (30) days of acceptance of an order, or the date quoted or acknowledged. Cutera shall give PSS prompt notice of any prospective failure to meet the acknowledged delivery date.

9.4 Cutera shall provide customer service support during its normal business hours.

9.5 Cutera shall provide PSS with annual calendars indicating holiday or other closures of shipping and customer service operations, and will provide at least thirty (30) days advance noticeof any changes to this calendar.

9.6 Cutera shall preserve, package, handle, and pack Products so as to protect the Products from loss or damage during shipment, in conformance with good commercial practice and any applicable government regulations. Cutera shall be responsible for any loss or damage to the Products during shipment that occurs due to its failure to properly preserve, package, handle, or pack Products. Cutera will ship Products in the final packaging as intended to be received by the end user as ordered.

9.7 Cutera will not apply any miscellaneous, transportation, handling, HAZMAT, accessorial, minimum order or pallet charges, surcharges or fees to any PSS purchase orders or deliveries unless (a) specifically approved in this agreement, and (b) detailed in order acknowledgements in accordance with Section 9.1 above.

10. ADVERTISING, PROMOTIONS, TRADEMARKS AND COPYRIGHTED MATERIAL

10.1 Cutera agrees to provide sample quantities of current or new sales literature, artwork, advertising materials, promotional plans and other information or programs reasonably related to this Agreement and the Products (“Advertising Materials”). Cutera warrants that no Advertising Materials will be misleading, deceptive, unfair or

otherwise violate any applicable laws, statutes or regulations. PSS specific literature and advertising will be the responsibility of PSS.

10.2 PSS, with input from Cutera, will evaluate requirements and define promotional plans to which PSS will utilize in connection with marketing and promoting the Products.

10.3 Cutera hereby grants PSS a revocable license to use any Cutera trademark or trade name associated with the Products solely in the advertisement and promotion of the Products during the term of this Agreement. Except as provided in this paragraph, PSS shall have no right, title or interest in or to any patent, trademark of trade name belonging to Cutera. Cutera hereby grants PSS a revocable license to reproduce materials provided to PSS by Cutera as is reasonable for promotion, demonstration, sale and support of Cutera Products, including but not limited to posting such materials on the Internet, Intranet, or web.

11. SALES, MARKETING AND SUPPORT OBLIGATIONS

11.1 PSS shall use commercially reasonable efforts to promote, market and solicit orders for the Products, and to represent the interests of Cutera at all times, to Physicians in the PSS Territory.

11.2 PSS shall, at its expense, maintain a properly trained sales force of adequate size to represent and promote the sale of the Products to Physicians throughout the PSS Territory. All of PSS's sales staff shall be employees of PSS. PSS recognizes and agrees that Cutera will be working cooperatively with PSS's sales persons, including efforts to qualify leads and conduct demonstrations.

11.3 PSS shall use commercially reasonable efforts to handle and resolve feedback from its customers. Subject to the limitations of, and without expanding, Cutera's product warranty obligations contained in Exhibit 2, attached hereto, Cutera shall (i) have ultimate responsibility for resolution of Product related issues; and, (ii) provide complete technical support to customers for all Products.

11.4 Cutera shall maintain a properly trained sales force of adequate size to provide marketing, demonstration and sales support for PSS's sales and distribution efforts under this Agreement. The sales representatives shall be geographically located strategically throughout the United States and shall be available to PSS as reasonably required in support of PSS's sales and distribution efforts with respect to Products.

11.5 Cutera shall provide demonstrations of the Products to Prospects as needed, and will provide all installation work for Products. Cutera agrees to provide sales and promotional support and after-sale service to all Prospects and PSS customers with the same diligence, quality and timelines as Cutera generally provides to its Prospects and Customers.

12. AGREEMENTS WITH CUSTOMERS

12.1 All sales and other agreements between PSS and its customers are PSS exclusively, and shall have no effect on the respective obligations of Cutera and PSS under this Agreement.

13. QUALITY ASSURANCE

13.1 Cutera agrees to maintain appropriate certification status and compliance with the Food and Drug Administration's (FDA) Quality System Regulation, the Medical Device Directive and/or all other applicable regulations. As manufacturer, Cutera will comply with all applicable regulations and standards that pertain to manufacturers for Products.

13.2 Upon request, Cutera agrees to furnish to PSS any information in its possession that is reasonably required to enable PSS to comply with all applicable regulations and standards that pertain to distributors for the Products.

13.3 If the Products and/or Territory covered in this Agreement are modified, then Cutera will maintain compliance with all laws and regulations applicable to manufacturers of Products where Products are manufactured and where Products are sold prior to the time that both Parties agree that the distribution is to commence.

13.4 Cutera represents, warrants, and covenants to PSS that all Products have been held under the manufacturer's recommended environmental conditions, including Products returned to Cutera from customers.

13.5 In the event Cutera installs electronic products regulated by the FDA, Cutera shall comply with all applicable Federal and State regulations. To the extent required by a government entity, Cutera shall be responsible for the completion and submission of relevant and applicable records to the FDA.

13.6 Cutera agrees to allow reasonable access to federally mandated quality assurance records, policies, and procedures for FDA regulated Products. Cutera agrees to reasonable access to manufacturing facilities for the purpose of performing vendor certification as required by the FDA.

14. MODIFICATION OF PRODUCTS

14.1 Cutera shall provide PSS written notice of all Product discontinuances no less than sixty (60) days prior to the last order date.

14.2 Cutera shall provide PSS with written notice of all material Product modifications or material Product packaging modifications not less than thirty (30) days prior to the shipment of Products that contain such modifications.

15. REPRESENTATIONS AND WARRANTIES

15.1 Products sold pursuant to this Agreement will come with Cutera's then-current product warranty, which will be solely for the benefit of, and assignable to, PSS'

customers. Cutera's current product warranty is attached hereto as Exhibit 2; provided, that Cutera may from time to time modify this warranty without any obligation or liability to PSS, provided that such modifications are applicable to Cutera's customers generally. If any Product is subject to a mandatory or voluntary recall issued by Cutera, Cutera shall reimburse PSS for any commercially reasonable and documented direct service and labor costs required to cooperate with such recall.

15.2 Cutera represents, warrants and covenants to PSS that:

i. Cutera is and will continue to be a duly formed and validly existing entity in good standing under the laws of the state of its organization

ii. Cutera has the full right, power and authority, corporate and/or otherwise, to execute and deliver this Agreement and to otherwise consummate the transactions contemplated by this Agreement.

iii. The execution, delivery and performance by Cutera under this Agreement, and the transactions and actions contemplated hereunder, have been duly authorized by all necessary actions by Cutera. This Agreement, when duly executed and delivered, constitutes a valid, legal and binding obligation of Cutera enforceable in accordance with its terms.

iv. The execution, consummation of the transactions contemplated by, and/or compliance with the terms and provisions of this Agreement, will not conflict with, result in a breach of, or constitute a default under any of the terms, conditions or provisions of Cutera constituent documents or any agreement, lease, indenture, mortgage, deed of trust, land contract, license or other instrument to which Cutera is a party or by which Cutera may be bound or affected or to which Cutera is subject, or any law, regulation, order, writ, injunction or decree of any court or agency or regulatory body.

v. Cutera has permission from the FDA to sell its Products throughout the United States to or on the order of licensed practitioners.

15.3 PSS represents, warrants and covenants to Cutera that:

i. PSS is and will continue to be a duly formed and validly existing entity in good standing under the laws of the state of its organization

ii. PSS has the full right, power and authority, corporate and/or otherwise, to execute and deliver this Agreement and to otherwise consummate the transactions contemplated by this Agreement.

iii. The execution, delivery and performance by PSS under this Agreement, and the transactions and actions contemplated hereunder, have been duly authorized by all necessary actions by PSS. This Agreement, when duly executed and delivered, constitutes a valid, legal and binding obligation of PSS enforceable in accordance with its terms.

iv. The execution, consummation of the transactions contemplated by, and/or compliance with the terms and provisions of this Agreement, will not conflict with, result in a breach of, or constitute a default under any of the terms, conditions or provisions of PSS constituent documents or any agreement, lease, indenture, mortgage, deed of trust, land contract, license or other instrument to which PSS is a party or by which PSS may be bound or affected or to which PSS is subject, or any law, regulation, order, writ, injunction or decree of any court or agency or regulatory body.

16. COMPLAINTS, QUALITY RECORDS AND RECALLS

16.1 PSS will notify, in writing, Cutera's quality assurance department of all Product complaints or any regulatory/conformance issues that may affect the marketability of Products. Cutera shall notify the appropriate regulatory agent(s) if required and shall conduct any safety investigations or other necessary follow-up activities. PSS will provide any information essential to such activities. Cutera will promptly notify PSS if corrective action is necessary in the Territory.

16.2 In the event of any recall of a Product required by a governmental agency for safety or efficacy reasons, or requested by Cutera at its sole discretion, Cutera agrees to repair or replace at its own costs and expense all Products subject to the recall and previously delivered to PSS or PSS customers. Cutera also agrees to consult with PSS to establish a reasonable process for managing the recall. Cutera shall be responsible for all reasonable expenditures incurred by PSS (including, but not limited to shipping, labor and travel costs) consistent with the recall process agreed to by the Parties, and consistent with HIDA and HDMA industry guidelines. In the event the recall is not required by a governmental agency for safety or efficacy reasons, but is instead requested by Cutera at its sole discretion, Cutera will be responsible for determining the scope of the recall, including the number of units, timeframe for the recall, and criteria for completion, at no cost or expense to PSS.

17. FORCE MAJEURE

No Party to this Agreement shall be liable for failure or delay of performance of any of its obligations hereunder if such failure or delay is due to causes beyond its reasonable control including, without limitation, natural disasters, fires, earthquake or storm, strikes, failures of public utilities or common carriers, acts of war, or intervention, acts restraints or regulations of any governmental authority, including compliance with any order of any governmental considerations; provided that any such delay or failure shall be remedied by such Party as soon as possible using commercially reasonable efforts after removal of the cause of such failure. A Party suffering such delay or which expects to suffer such delay shall promptly notify the other Party in writing of the cause and expected duration of such delay. In the event a delay lasts or is expected to last more than thirty (30) days, then either Party shall have the option to terminate this Agreement upon written notice.

18. CONFIDENTIALITY

18.1 Return of Confidential Information. Each party shall return to the other all Confidential Information (as defined below) received from that other party, along with all copies, immediately upon the termination of this Agreement.

18.2 Remedies. Each party shall be liable to the other for damages caused by any breach of this Section18 or by any unauthorized disclosure or use of the other's Confidential Information by such party or third parties to whom unauthorized disclosure was made. In addition to any other rights or remedies which may be available to it, each party shall be entitled to seek appropriate injunctive relief or specific performance to prevent unauthorized use or disclosure of Confidential Information. Each party acknowledges and agrees that the unauthorized use or disclosure of the other party's Confidential Information will cause irreparable injury to the other party and that money damages will not provide adequate remedy to the other party.

18.3 Confidential Information. The business and technical information developed or acquired by, or entrusted by a third party to, each party, including, but not limited to, customer lists, names, contact information, addresses, telephone numbers, email addresses, Product designs, manufacturing processes, Product pricing, pricing strategies and Pricing Information (as defined and subject to the provisions of Section 18.4, below), business plans, and all related trade secrets ("Confidential Information") are the exclusive property of such party, are among such party's valuable assets, and their value to that party may be lost by their unauthorized use or disclosure to persons or entities not related to such party. Neither party shall, directly or indirectly, use the other party's Confidential Information received hereunder (other than directly in connection with its obligations hereunder) or disclose or disseminate it to any party or entity during the Term of this Agreement or at any time for three years thereafter (subject to the exceptions below), regardless of the reason for such expiration, without the express written consent of the other party. This obligation of confidentiality shall not apply to any Confidential Information which (i) was properly and lawfully known to the receiving party at the time of receipt without any misconduct on the receiving party's part; (ii) was in the public domain at the time of receipt; (iii) becomes public through no wrongful act of the party obligated to keep it confidential; (iv) is properly received by the receiving party from a third party who did not thereby violate any confidentiality obligations to the disclosing party; or (v) is required by applicable law to be divulged.

19. INDEMNIFICATION

19.1 Cutera shall, except as otherwise provided below, indemnify, and hold PSS harmless, and defend or settle any claim made or any suit proceeding, including reasonable attorneys fees, brought against PSS and its Affiliates, arising out of or relating to an allegation that any Product infringes a patent, copyright, trademark, trade secret, or other intellectual property right of any third party. PSS shall (a) promptly notify Cutera in writing of any such claim, (b) cooperate with Cutera in connection with the defense of such claim, and (c) give Cutera the sole authority to defend or settle the claim (at Cutera's expense). Cutera shall pay all damages and costs finally awarded in any such suit or proceeding against PSS, or any settlement amount required to settle the claim. In the event the Product is held to infringe and the use or sale of said Product is enjoined, Cutera shall have the option at its

own expense, to procure for PSS the right to continue using or selling said Product, or replace same with a non-infringing Product, or modify same so it becomes non-infringing. In the event Cutera is unable to accomplish either of the foregoing remedies after using commercially reasonable efforts to do so, Cutera shall grant a refund to PSS of the price paid by PSS for any of such Products returned to Cutera by PSS, but only to the extent such Products were in PSS' inventory and had not been shipped to a customer site. Notwithstanding anything to the contrary above, in no event shall Cutera have any liability under this Section for any such claims resulting from (a) modifications to the Products by anyone other than Cutera where the unmodified Products do not infringe and Cutera did not authorize the modification; (b) the combination of the Products with other products not provided or authorized by Cutera; or (c) use of the Products for purposes for which they were not intended. THE FOREGOING IS CUTERA'S SOLE LIABILITY RELATING TO ANY CLAIMS OF INFRINGEMENT OF ANY THIRD PARTY INTELLECTUAL PROPERTY RIGHTS. CUTERA EXPRESSLY DISCLAIMS ALL OTHER WARRANTIES, WHETHER EXPRESS OR IMPLIED, RELATING TO CLAIMS THAT ITS PRODUCTS INFRINGE ANY INTELLECTUAL PROPERTY RIGHTS.

19.2 Cutera shall indemnify, defend and hold PSS and its Affiliates harmless from and against any and all liabilities, claims, demands, damages, costs and expenses or money judgments (including reasonable attorneys fees) asserted against, incurred by or rendered against any of them from (a) third party claims or actions for personal injury, death or property damage which arise out of Cutera's breach of any of its covenants or representations set forth herein, or a defect due to defective design, parts, packaging, labeling, Cutera provided advertising materials, faulty workmanship of Products of which Cutera is the manufacturer or is the Party responsible for failure to warn except to the extent that such personal injuries, death or property damage arise out of PSS's (or its Affiliates) or any third party's negligence or breach of this Agreement (as set forth in herein), (b) third party claims or actions arising from Cutera's negligence, breach of this Agreement or willful misconduct and (c) mandatory or voluntary recalls of any Products.

19.3 PSS shall and does hereby agree to indemnify and hold harmless Cutera and its Affiliates from and against any and all liability, loss, cost, claim, injury, damage, demand or expense (including, without limitation, reasonable attorneys' fees) of any kind whatsoever arising out of, relating to, on account of, or in connection with (a) any instruction, specification or labeling supplied by PSS regarding the Product, unless Cutera has concurred in writing with such instruction, specification or labeling; (b) any use of the Product in a manner described by PSS, unless Cutera has prescribed in written materials; (c) any marketing, sale, installation, servicing or repair of the Product by PSS not in accordance with Cutera's written consent and procedures; (d) any breach by PSS of this Agreement; or (e) PSS' negligence or willful misconduct. This indemnity shall survive the termination or expiration of this Agreement.

19.4 The indemnification obligations under this Agreement shall survive termination or expiration of this Agreement for any reason.

20. LIMITATION OF LIABILITY

EXCLUDING CLAIMS FOR INDEMNIFICATION, IN NO EVENT SHALL EITHER PARTY BE LIABLE TO THE OTHER PARTY FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL, OR PUNITIVE DAMAGES OF ANY KIND WHATSOEVER INCLUDING BUT NOT LIMITED TO LOST PROFITS, IN CONJUNCTION WITH OR ARISING OUT OF THE PERFORMANCE UNDER THIS AGREEMENT OR THE USE OR PERFORMANCE OF PRODUCTS AND SUPPORT SERVICES EVEN IF THE OTHER PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES.

21. INTELLECTUAL PROPERTY RIGHTS

21.1 All intellectual property rights relating to Cutera, the Products and this Agreement, including all names, trademarks, copyrights, patents, mask works, trade secrets, know-how, technology, computer software and related documentation and source code and other intellectual property rights, are and shall remain the property of Cutera and nothing in this Agreement shall be deemed to grant to PSS a license or other right to use Cutera's intellectual property except as expressly set forth herein. Cutera hereby grants PSS the right to use its name and trademarks solely in compliance with such rules as Cutera may establish from time to time. PSS will not create or distribute any marketing or promotional material relating to Cutera or the Products without Cutera's prior written consent.

22. INSURANCE

Cutera shall obtain, pay for and maintain the following insurance coverages:

22.1 Comprehensive Commercial General Liability insurance, including contractual liability insurance and product liability insurance against claims regarding the Products and its activities contemplated by this Agreement, in an amount not less than one million dollars ($1,000,000) Combined Single Limit bodily Injury & Property Damage Each Occurrence / three millions dollars ($3,000,000) Aggregate, including coverage for products and completed operations, contractual liability insuring the obligations assumed by Cutera under this Agreement, independent contractors, and personal and advertising injury coverages.

22.2 Cutera shall name PSS World Medical Inc. and its Subsidiaries, as an additional insured with respect to its Commercial General Liability policy. Cutera shall maintain such insurance during the term of this Agreement and thereafter for so long as it maintains insurance for itself covering such activities. Coverage shall be written on a Standard ISO Occurrence Form CG00010196 or its equivalent. Upon execution of this Agreement, and annually for the term of this Agreement, Cutera will provide certificates and renewal certificates of insurance reflecting such policy and coverages as required above. Such certificates shall reflect that the underlying policy has been endorsed to provide at least thirty (30) days prior written notice to PSS of the cancellation, non-renewal, reduction or material change of any such insurance coverage.

Please send the Certificate of Liability insurance to:

PSS World Medical, Inc.

Attn: Compliance Dept., Melanie Goodwin
4345 Southpoint Blvd.
Jacksonville, FL 32216

23. CONFLICT RESOLUTION

23.1 Each party shall designate (in writing, if requested by the other party) a relationship manager responsible for the day to day management and coordination of the party's performance under this Agreement, and the parties' communications, transactions and relationship with each other. The relationship managers shall address conflicts that arise relative to this Agreement. If these relationship managers can not resolve such conflicts, then Cutera and PSS shall promptly establish a review board comprised of appropriate members of management from Cutera and PSS to resolve the conflict.

23.2 In the event that the review board of the Parties does not resolve a dispute within thirty (30) days from the date the review board is established, then the Parties agree to submit the dispute to non-binding mediation. If the Parties do not resolve the dispute through mediation within four months from the date such conflict arose, then either of the Parties may elect to pursue any remedies available at law.

24. GENERAL

24.1 Entire Agreement. This Agreement constitutes the entire Agreement between the parties concerning the subject matter hereof and supersedes any prior written or verbal agreements or understandings in connection herewith. No amendment, waiver or modification hereto or hereunder shall be valid unless specifically made in writing and signed by an authorized signatory of each of the parties hereto. No form, invoice, bill of lading, shipping document, order, receipt or other document provided by a Party shall operate to supercede, modify or amend any provisions of this Agreement, even if the other Party has initialed, signed or otherwise acknowledged such document, unless the document expressly states that it modifies or amends this Agreement and is signed by an authorized representative of PSS and Cutera. Neither Party's failure to exercise any of its rights under this Agreement will constitute or be deemed a waiver or forfeiture of those rights. All Exhibits attached to the Agreement shall be deemed a part of this Agreement and incorporated herein. Terms that are defined in this Agreement, and used in any Exhibit, have the same meaning in the Exhibit as in this Agreement. The provisions of an Exhibit shall prevail over any conflicting provisions of the body of this Agreement.

24.2 Publicity. During the term of this Agreement and for three years thereafter for any reason, neither party shall make any media release or other public announcement relating to or referring to this Agreement without the other party's prior written consent. Neither party shall acquire the right to use, and shall not use, without prior written consent, the terms or existence of this Agreement, the names, trade names, trademarks, service marks, artwork, designs, or copyrighted materials, of the other party, its related or subsidiary companies, parent, employees, directors, shareholders, assigns, successors or licensees: (a) in any advertising, publicity, press release, client list, presentation or promotion; (b) to express or to imply any endorsement of the other party; or (c) in any manner other than expressly in accordance with this Agreement, except when required or necessitated by applicable law.

24.3 Notices. All notices and other communications required or permitted hereunder shall be in writing and shall be mailed by registered or certified mail or delivered either by hand or by messenger, or sent via fax, addressed to the address set forth at the foot of this Agreement. Any notice or other communication so addressed and mailed by registered or certified mail (in each case, with return receipt requested) shall be deemed to be delivered and given when so mailed. Any notice or other communication so addressed and delivered by hand, by messenger or by fax shall be deemed to be given when actually received by the addressee.

24.4 Venue and Jurisdiction. The laws of the State of New York will govern any disputes arising in connection with this Agreement, without regard to its conflicts of laws, rules or principles.

24.5 Attorneys' Fees. In any action relating to this Agreement, the prevailing party shall be entitled to recover reasonable attorneys' fees and other costs incurred therein, in addition to any other appropriate relief.

24.6 Severability. If for any reason any provision of this Agreement shall be deemed by a court of competent jurisdiction to be legally invalid or unenforceable, the validity of the remainder of the Agreement shall not be affected and the offending provision shall be deemed modified to the minimum extent necessary to make it consistent with applicable law, and, in its modified form, the provision shall then be enforceable and enforced.

24.7 Captions. The section headings and captions of this Agreement are for convenience and reference only and in no way define, limit or describe the scope or intent of this Agreement nor substantively affect it in any way.

24.8 Survival. Sections 4.2, 5.4, 8, 12, 18, 19, 20, 21, 23 and 24, and all other provisions that by their terms the parties' reasonably contemplate as remaining in effect after termination or expiration of this Agreement, shall survive termination or expiration of this Agreement for any reason.

IN WITNESS WHEREOF, the parties have executed this Agreement to be executed by their duly authorized representatives.

Cutera, Inc. a Delaware corporation	PSS WORLD MEDICAL SHARED SERVICES, INC., a Florida corporation
By: /s/ Ronald J. Santilli	By: /s/ Eric S. Miller
Printed: Ronald J. Santilli	Printed: Eric S. Miller
Its: VP & CFO	Its: VP of Finance — PSS

EXHIBIT 1

PRODUCTS AND PRICE LIST

CUTERA®

Products are sold with a standard 1 year warranty

2006 PSS PRICING MATRIX CARD
Effective October 1, 2006

EQUIPMENT:		Equipment Pricing [***]	Equipment Pricing [***]	Annual Service Contract Pricing [***]	Annual Service Contract Pricing [***]	Annual Service Contract Pricing [***]	Annual Service Contract Pricing [***]
CoolGlide Platform:							
CV		[***]	[***]	[***]	[***]	[***]	[***]
Excel		[***]	[***]	[***]	[***]	[***]	[***]
Vantage		[***]	[***]	[***]	[***]	[***]	[***]
Solera Platform (Includes cart):		[***]	[***]	[***]	[***]	[***]	[***]
Solera Opus with 1 flashlamp handpiece		[***]	[***]	[***]	[***]	[***]	[***]
Solera Titan with Titan S handpiece		[***]	[***]	[***]	[***]	[***]	[***]
Solera Titan with Titan V handpiece		[***]	[***]	[***]	[***]	[***]	[***]
Solera Titan with Titan XL handpiece		[***]	[***]	[***]	[***]	[***]	[***]
Xeo Platform (with Navigation):		[***]	[***]	[***]	[***]	[***]	[***]
Xeo Light - IPL only with 1 flashlamp handpiece		[***]	[***]	[***]	[***]	[***]	[***]
Xeo Rejuvenation w/FV, Genesis, 1 flashlamp rejuvenation handpiece		[***]	[***]	[***]	[***]	[***]	[***]
Xeo Vantage - Yag only **(a)**		[***]	[***]	[***]	[***]	[***]	[***]
Xeo Core w/HR, Genesis, and 1 flashlamp handpiece		[***]	[***]	[***]	[***]	[***]	[***]
Xeo Hair w/HR, FV, LV, and ProWave 770 handpiece		[***]	[***]	[***]	[***]	[***]	[***]
Xeo Full w/HR, FV, LV, Genesis, and 1 flashlamp handpiece		[***]	[***]	[***]	[***]	[***]	[***]
All XEO options can also include Titan:	Titan S	[***]	[***]	[***]	[***]	[***]	[***]
	Titan V	[***]	[***]				
	Titan XL	[***]	[***]				

[***]

[***]

Titan handpieces are not covered under the system contract or warranty, they remain limited to the shot count warranty.

UPGRADES: ***Requirements and Eligibility:***

1) Service must be contacted for pricing when equipment is not under warranty or service contract.

2) Upgrades can only be made to **CoolGlide** and the **Xeo Full** platforms.

3) 90 day warranty on all upgraded parts

SYSTEM UPGRADE PRICING:

TO PLATFORM---->	EXCEL [***]	EXCEL [***]	VANTAGE [***]	VANTAGE [***]	XEO Full [***]	XEO Full [***]
FROM PLATFORM						
CoolGlide Platform:						
CV	[***]	[***]	[***]	[***]	[***]	[***]
Excel			[***]	[***]	[***]	[***]
Vantage					[***]	[***]
Solera Platform:						
Solera Opus					[***]	[***]
Xeo Platform:						
Xeo Light - IPL only with 1 flashlamp handpiece					[***]	[***]
Xeo Rejuvenation w/FV, Genesis, 1 flashlamp rejuvenation handpiece					[***]	[***]
Xeo Vantage - Yag only					[***]	[***]
Xeo Core w/HR, Genesis, and 1 flashlamp handpiece					[***]	[***]
Xeo Hair w/HR, FV, LV, and ProWave 770 handpiece					[***]	[***]

HANDPIECE, AND TITAN FIELD UPGRADE PRICING:

	[***]	[***]
IPL handpiece field upgrades (one handpiece only)	[***]	[***]
Titan XL handpiece upgrade for existing Titan cust.	[***]	[***]
Add Titan with Titan S handpiece to XEO platform	[***]	[***]
Add Titan with Titan V handpiece to XEO platform	[***]	[***]
Add Titan with Titan XL handpiece to XEO platform	[***]	[***]

NAVIGATION AND LIMELIGHT UPGRADE INTRODUCTORY PRICING FOR XEO ONLY:

	Customer shipment date [***]	Customer shipment date [***]
Navigation	[***]	[***]
LimeLight	[***]	[***]
Navigation and LimeLight	[***]	[***]
Navigation color scheme	[***]	[***]

SOFTWARE UPGRADES:

	Pricing (USD)	
	[***]	[***]
Factory software upgrades for using handpieces interchangeably		
Non-Titan applications	[***]	[***]
Titan applications	[***]	[***]
Field software upgrades for using handpieces interchangeably		
Non-Titan applications	[***]	[***]
Titan applications	[***]	[***]

Accessories and replacement handpieces

	Pricing (USD)	
ACCESSORIES:	[***]	[***]
Omnilux system	[***]	[***]
Solera Cart	[***]	[***]
Cutera Success 1-day training	[***]	[***]
Cutera Success 2-day training	[***]	[***]
3D Symposium	[***]	[***]
1st additional Flashlamp handpiece (a)	[***]	[***]
2nd additional flashlamp handpiece	[***]	[***]
Titan XL handpiece (b)	[***]	[***]

(a) Pricing applies when shipped with system from the factory

(b) Pricing applies when shipped with Titan S or Titan V from factory

[*] = CERTAIN CONFIDENTIAL INFORMATION CONTAINED IN THIS DOCUMENT, MARKED BY BRACKETS, HAS BEEN OMITTED AND FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION PURSUANT TO RULE 24B-2 OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

EXHIBIT 2
CUTERA'S PRODUCT WARRANTY

Cutera warrants solely to the end-user customer, for one year from initial shipment of a Product manufactured by Cutera (but, with respect to a non-laser Handpiece, for the certain period from shipment or for the certain number of shots of that handpiece following its shipment, whichever is first to occur, all as provided on the face of the applicable purchase agreement), that such Product will be free from defects in workmanship and materials. This warranty is subject to proper use, operation and maintenance of the Product in accordance with the operator manual, and shall not apply if the Product has been damaged after shipment to the customer, or misused, altered, disassembled or serviced by any person other than Cutera. Cutera's sole obligation under this warranty shall be, at Cutera's option, to repair or replace any Product defect that was present when the Product was first shipped. Products repaired or replaced under warranty and components thereof will be warranted as provided in this subsection for the remainder of the original Product's original warranty period. Product upgrades and the underlying system consoles (which exclude handpieces) will be warranted as provided in this subsection for the remainder of the consoles' original warranty period. Notwithstanding anything to the contrary: (i) software and firmware licensed herein will be warranted as provided in this subsection for ninety days from shipment; and, (ii) Cutera makes no warranties with respect to a Product's removable hand piece window, or to Products not manufactured by Cutera. THE FOREGOING PRODUCT WARRANTIES AND REMEDIES ARE EXCLUSIVE AND IN LIEU OF ALL OTHERS. EXCEPT AS SO STATED, CUTERA DISCLAIMS ALL PRODUCT WARRANTIES, EXPRESS AND IMPLIED, INCLUDING IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE.

EXHIBIT 31.1

Certification of Chief Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Kevin P. Connors, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cutera, Inc.:

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2006

/s/ Kevin P. Connors

Kevin P. Connors
President, Chief Executive Officer
and Director (Principal Executive Officer)

EXHIBIT 31.2

Certification of Chief Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Ronald J. Santilli, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cutera, Inc.:

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2006

/s/ Ronald J. Santilli

Ronald J. Santilli
Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit 32.1

CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER
AND CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Kevin P. Connors, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2006 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 8, 2006

/s/ Kevin P. Connors
Kevin P. Connors
President, Chief Executive Officer
and Director
(Principal Executive Officer)

I, Ronald J. Santilli, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2006 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 8, 2006

/s/ Ronald J. Santilli
Ronald J. Santilli
Chief Financial Officer
(Principal Financial and Accounting Officer)

This certification accompanies this Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended.