BIOLASE TECHNOLOGY INC
Form 10-Q/A
July 19, 2005
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

(Mark One)

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

For the quarterly period ended March 31, 2004

OR

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

For the transition period from _____ to _____

Commission File Number 000-19627

BIOLASE TECHNOLOGY, INC.

(Exact Name of Registrant as Specified in Its Charter)

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

981 Calle Amanecer

San Clemente, California 92673

(Address of principal executive offices, including zip code)

(949) 361-1200

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes x No ¨

Number of shares outstanding of the registrant s common stock, $0.001 par value, as of April 30, 2004: 24,263,567.

Table of Contents

BIOLASE TECHNOLOGY, INC.

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A (this Form 10-Q/A) amends our Quarterly Report on Form 10-Q for the first fiscal quarter ended March 31, 2004, as initially filed with the Securities and Exchange Commission (the SEC) on May 10, 2004, and is being filed to reflect the restatement of our consolidated financial statements for the three months ended March 31, 2004 and 2003, as discussed in Note 3 thereto.

As reported in the Form 8-K filed May 20, 2005, we decided to restate our financial statements after reaching the conclusion that we had under accrued sales tax and related penalties and interest for fiscal 2002. The impact of these sales tax and related adjustments that impacted 2002, 2003 and the first three quarters of 2004, as well as other adjustments in the areas of value-added tax (VAT), payroll and related accruals, deferred revenue, and other accrued liabilities have led our management to recommend, and our Audit Committee to conclude, that the consolidated financial statements as of and for the years ended December 31, 2003 and 2002, the four quarters of 2003 and the first three quarters of 2004 also need to be restated.

We are restating the unaudited consolidated financial statements in this Form 10-Q/A to correct for the following items:

- Under accrual of sales tax, and penalties and interest, and the reflection of subsequent abatement for a portion of the penalties and interest
- Refunds that were recorded for VAT, understating our VAT payable
- Training services and consumables in our multiple element arrangements for which these applicable elements of revenue were overstated
- Recognition of revenue on a Waterlase system that was not fully functional at the time of shipment
- Write-off of an account receivable balance for which revenue was improperly recognized
- Accruals for bonuses, commissions, payroll, health and dental insurance
- Understatement of our excess and obsolete inventory reserve for items that had previously been reserved
- Adjustments identified but not originally recorded that were previously determined to be immaterial

Except for the foregoing amended information required to reflect the effects of the restated consolidated financial statements, this Form 10-Q/A continues to describe conditions as presented in the original report on Form 10-Q. The Form 10-Q/A does not reflect events occurring after the filing of the Form 10-Q, or modify or update those disclosures, including exhibits to the Form 10-Q affected by subsequent events. Information not affected by the restatement is unchanged and reflects the disclosures made at the time of the original filing of the Form 10-Q on May 10, 2004. Accordingly, this Form 10-Q/A should be read in conjunction with our filings made with the SEC subsequent to the filing of the original Form 10-Q, including any amendments to those filings. The following items have been amended (and conforming changes have been made where indicated as restated) as a result of the restatement:

Part I Item 1 Financial Statements (unaudited)

Part I Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations

Part I Item 4 Controls and Procedures

The restated consolidated financial statements as of December 31, 2003 and for the years ended December 31, 2002 and 2003 will be included in our Form 10-K as of and for the year ended December 31, 2004. The restatement of the other quarterly and year-to-date periods for 2003 and 2004 will be included in amendments to our Form 10-Q/A for the quarters ended June 30, 2004 and September 30, 2004.

Concurrently with the filing of this Form 10-Q/A, we are filing with the SEC the Form 10-K as of and for the year ended December 31, 2004, which includes the financial statements as of December 31, 2003 and the two years ended December 31, 2003, on a restated basis, and the Form 10-Q/A for the second and third quarters of 2004 to reflect changes required as a result of the restatements described above. No amendments have been made to our previously filed Annual Reports on Form 10-K for fiscal years 2002 or 2003, or the Quarterly Reports on Form 10-Q for the quarters ended March 31, 2003, June 30, 2003 and September 30, 2003 and therefore they should not be relied upon.

Table of Contents

BIOLASE TECHNOLOGY, INC.

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

BIOLASE TECHNOLOGY, INC.

CONSOLIDATED BALANCE SHEETS (Unaudited)

	MARCH 31, 2004	DECEMBER 31, 2003
	RESTATED	RESTATED
ASSETS		
Current assets:		
Cash and cash equivalents	$ 50,095,000	$ 11,111,000
Accounts receivable, less allowance of $57,000 and $64,000 in 2004 and 2003, respectively	6,205,000	5,771,000
Inventory	4,038,000	3,808,000
Deferred tax asset	1,508,000	1,508,000
Prepaid expenses and other current assets	1,060,000	1,260,000
Total current assets	62,906,000	23,458,000
Property, plant and equipment, net	1,988,000	1,973,000
Intangible assets, net	2,594,000	2,587,000
Goodwill	2,926,000	2,926,000
Deferred tax asset, net of current portion	13,473,000	12,651,000
Other assets	107,000	1,041,000
Total assets	$ 83,994,000	$ 44,636,000
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Line of credit	$	$ 1,792,000
Accounts payable	2,007,000	3,796,000
Accrued liabilities	5,184,000	5,551,000
Deferred revenue	1,281,000	1,229,000
Deferred gain on sale of building current portion	63,000	63,000
Debt		888,000
Total current liabilities	8,535,000	13,319,000
Deferred gain on sale of building	63,000	79,000
Total liabilities	8,598,000	13,398,000
Commitment and Contingencies (Note 9)		
Stockholders equity:		

Preferred stock, par value $0.001, 1,000,000 shares authorized, no shares issued and outstanding		
Common stock, par value $0.001, 50,000,000 shares authorized; issued and outstanding 24,254,000 shares in 2004 and 21,559,000 shares in 2003	24,000	22,000
Additional paid-in capital	102,686,000	59,134,000
Accumulated other comprehensive loss	(159,000)	(147,000)
Accumulated deficit	(27,155,000)	(27,771,000)
Total stockholders equity	75,396,000	31,238,000
Total liabilities and stockholders equity	$ 83,994,000	$ 44,636,000

See accompanying notes to consolidated financial statements.

Table of Contents

BIOLASE TECHNOLOGY, INC.

CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	THREE MONTHS ENDED MARCH 31,	
	RESTATED 2004	RESTATED 2003
Net revenue	$ 14,530,000	$ 9,198,000
Cost of revenue	5,686,000	3,378,000
Gross profit	8,844,000	5,820,000
Other income, net	16,000	16,000
Operating expenses:		
Sales and marketing	5,336,000	3,652,000
General and administrative	1,667,000	833,000
Engineering and development	772,000	512,000
Total operating expenses	7,775,000	4,997,000
Income from operations	1,085,000	839,000
Non-operating (loss) income, net	(61,000)	54,000
Income before income taxes	1,024,000	893,000
Provision for income taxes	(408,000)	
Net income	$ 616,000	$ 893,000
Net income per share:		
Basic	$ 0.03	$ 0.04
Diluted	$ 0.03	$ 0.04
Shares used in the calculation of net income per share:		
Basic	22,443,000	20,383,000
Diluted	23,777,000	22,149,000

See accompanying notes to consolidated financial statements.

Table of Contents

BIOLASE TECHNOLOGY, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	THREE MONTHS ENDED MARCH 31,	
	RESTATED 2004	RESTATED 2003
Cash Flows From Operating Activities:		
Net income	$ 616,000	$ 893,000
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	146,000	65,000
Gain on disposal of assets	(16,000)	(16,000)
Gain on foreign exchange contract		(22,000)
Provision for uncollectible accounts	17,000	148,000
Provision for inventory obsolescence	29,000	107,000
Deferred tax asset	407,000	
Changes in assets and liabilities:		
Accounts receivable	(451,000)	1,002,000
Inventory	(259,000)	(990,000)
Prepaid expenses and other assets	1,134,000	610,000
Accounts payable and accrued liabilities	(2,140,000)	(685,000)
Deferred revenue	36,000	(595,000)
Net cash (used in) provided by operating activities	(481,000)	517,000
Cash Flows From Investing Activities:		
Additions to property, plant and equipment	(134,000)	(39,000)
Business acquisition	(70,000)	
Net cash used in investing activities	(204,000)	(39,000)
Cash Flows From Financing Activities:		
Payment on line of credit	(1,792,000)	
Payments on insurance notes	(888,000)	(156,000)
Proceeds from issuance of common stock, net of expenses	41,877,000	
Proceeds from exercise of stock options and warrants	448,000	1,640,000
Net cash provided by financing activities	39,645,000	1,484,000
Effect of exchange rate changes on cash	24,000	(26,000)
Net increase in cash and cash equivalents	38,984,000	1,936,000
Cash and cash equivalents at beginning of period	11,111,000	3,875,000
Cash and cash equivalents at end of period	$ 50,095,000	$ 5,811,000

SUPPLEMENTAL CASH FLOW DISCLOSURE:		
Cash paid during the period for interest	$ 20,000	$ 8,000
Cash paid during the period for taxes	$ 45,000	$ 2,000

See accompanying notes to consolidated financial statements.

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

NOTE 1 BASIS OF PRESENTATION

The accompanying interim consolidated financial statements as of March 31, 2004 and for the three months ended March 31, 2004 and 2003 are unaudited and have been restated (Note 3). The accompanying consolidated balance sheet as of December 31, 2003 has also been restated (Note 3). The unaudited consolidated financial statements include the accounts of BIOLASE® Technology, Inc. and its consolidated subsidiaries and have been prepared on a basis consistent with the audited annual consolidated financial statements and include all material adjustments, consisting of normal recurring adjustments and the elimination of all material intercompany transactions and balances, necessary to fairly state the information set forth therein. These unaudited, interim, consolidated financial statements do not include all the footnotes, presentations and disclosures normally required by generally accepted accounting principles in the United States of America (GAAP) for complete financial statements. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2004 filed with the Securities and Exchange Commission (the SEC) on the same date as this Form 10-Q/A has been filed.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may differ materially from those estimates.

The results of operations for the three months ended March 31, 2004 are not necessarily indicative of the results to be expected for the full fiscal year.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenue Recognition

We sell products domestically to customers through our direct sales force, and internationally through a direct sales force and through distributors. We recognize revenue in accordance with SEC Staff Accounting Bulletin No. 104 which requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred and title and the risks and rewards of ownership have been transferred to our customer or services have been rendered; (3) the price is fixed and determinable; and (4) collectibility is reasonably assured.

Through August 2003, we recognized revenue for products sold domestically when we received a purchase order, the price was fixed or determinable, and payment was received due to a clause in our purchase order that stated that title transfers upon payment in full. We recognized revenue for products sold internationally through our direct sales force when we received a purchase order, the price was fixed or determinable, collectibility of the resulting receivable was probable and installation was completed, which was when the customer became obligated to pay. We recognized revenue for products sold through our distributors internationally when we received a purchase order, the price was fixed or determinable, collectibility of the resulting receivable was probable and the product was delivered. In August 2003, we modified the sales arrangements with our customers so that title transfers to the customer upon shipment for domestic sales, and there is an enforceable obligation to pay upon shipment for international direct sales. Beginning in August 2003, we have been recording revenue for all sales upon shipment.

We adopted EITF 00-21, Accounting for Revenue Arrangements with Multiple Deliverables, on July 1, 2003, which requires us to evaluate whether the separate deliverables in our arrangements can be unbundled. We determined that the sales of our Waterlase® includes separate deliverables consisting of the product, disposables used with the Waterlase, installation and training. We apply the residual value method, which requires us to allocate the total arrangement consideration less the fair value of the undelivered elements to the delivered element. Included in deferred revenue as of March 31, 2004 and December 31, 2003 is $925,000 (restated) and $887,000 (restated) respectively of deferred revenue attributable to the undelivered elements which primarily consist of training and installation.

Although all sales are final, we accept returns of products in certain circumstances and record a provision for sales returns based on historical experience concurrent with the recognition of revenue. The sales returns allowance is recorded as a reduction of accounts receivable, revenue and costs of goods sold. As of March 31, 2004 and December 31, 2003, respectively, $247,000 and $327,000 was recorded as a reduction of accounts receivable.

Extended warranty contracts, which are sold to our non-distributor customers, are recorded as revenue on a straight-line basis over the period of the contracts, which is one year. Included in deferred revenue as of March 31, 2004 and December 31, 2003 is $356,000 and $342,000 of deferred revenue for our extended warranty contracts, respectively.

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Provision for Warranty Expense

Products sold directly to end users are under warranty against defects in material and workmanship for a period of one year. Products sold internationally to distributors are covered by a warranty on parts for up to fourteen months with additional coverage on certain components for up to two years. We estimate warranty costs at the time of product shipment based on historical experience. Estimated warranty expenses are recorded as an accrued liability, with a corresponding provision to cost of revenue.

Changes in the product warranty accrual, including expenses incurred under our initial and extended warranties, for the three months ended March 31, 2004 and 2003 were as follows:

	Three Months Ended March 31,	
	2004	2003
Beginning balance	$ 727,000	$ 625,000
Provision for estimated warranty cost	253,000	290,000
Warranty expenditures	(167,000)	(290,000)
Ending balance	$ 813,000	$ 625,000

Stock based compensation

We measure compensation expense for stock-based employee compensation plans using the intrinsic value method in accordance with APB No. 25. As the exercise price of all options granted under these plans was equal to the fair market price of the underlying common stock on the grant date, no stock-based employee compensation cost is recognized in the consolidated statements of income.

On December 31, 2002 the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standard (SFAS) No. 148, Accounting for Stock Based Compensation Transition and Disclosure, which amends SFAS No. 123. SFAS No. 148 requires more prominent and more frequent disclosures about the effects of stock-based compensation by presenting pro forma net income (loss), pro forma net income (loss) per share and other disclosures concerning our stock-based compensation plan.

The following table illustrates the effect on net income and net income per share if we had applied the fair value recognition provisions of SFAS No. 123 to options granted under our stock-based employee compensation plans.

	Three Months Ended March 31,	
	Restated 2004	Restated 2003
Reported net income	$ 616,000	$ 893,000
Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(477,000)	(359,000)
Pro-forma net income	$ 139,000	$ 534,000
Basic net income per share:		
Reported	$ 0.03	$ 0.04
Pro-forma	$ 0.01	$ 0.03
Diluted net income per share:		
Reported	$ 0.03	$ 0.04
Pro-forma	$ 0.01	$ 0.02

The pro-forma net income has been revised to reflect the restatement of our unaudited consolidated financial statements described in Note 3 and to reflect revisions in the calculation to stock-based employee compensation expense.

The pro forma amounts were estimated using the Black-Scholes option-pricing model with the following assumptions:

	Three Months Ended March 31,	
	2004	2003
Expected term (years)	3.50	3.50
Volatility	66%	80%
Annual dividend per share	0%	0%
Risk free interest rate	2.33%	2.03%
Weighted average fair value	$ 8.75	$ 3.58

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Our options have characteristics significantly different from those of traded options, and changes in the subjective input assumptions can materially affect the fair value estimate.

Net Income Per Share Basic and Diluted

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

Stock options totaling 37,000 and 87,000 were not included in the diluted earnings per share amounts for the three months ended March 31, 2004 and March 31, 2003, respectively, as their effect would have been anti-dilutive.

	Three Months Ended March 31,	
	2004 Restated	2003 Restated
Weighted average shares outstanding basic	22,443,000	20,383,000
Dilutive effect of stock options and warrants	1,334,000	1,766,000
Weighted average shares outstanding diluted	23,777,000	22,149,000

The dilutive effect of stock options and warrants was decreased by 901,000 and increased by 251,000 for the three months ended March 31, 2004 and 2003, respectively, to reflect a revision in the calculation.

Inventory

We value inventory at the lower of cost or market (determined by the first-in, first-out method). We periodically evaluate the carrying value of inventory and maintain an allowance for obsolescence to adjust the carrying value to the lower of cost or market, based on physical and technical functionality as well as other factors affecting the recoverability of the asset through future sales. The allowance for obsolescence is adjusted based on such evaluation, with a corresponding provision included in cost of revenue. Components of inventory were as follows:

	March 31, 2004 Restated	December 31, 2003 Restated
Materials	$ 1,847,000	$ 1,725,000
Work-in-process	907,000	894,000
Finished goods	1,284,000	1,189,000
Inventory	$ 4,038,000	$ 3,808,000

Property, Plant and Equipment

We state property, plant and equipment at acquisition cost less accumulated depreciation and amortization. The cost of property, plant and equipment is depreciated using the straight-line method over the estimated useful lives of the respective assets, except for leasehold improvements, which are amortized over the lesser of the estimated useful lives of the respective assets or the related lease terms. Maintenance and repairs are expensed as incurred. Upon sale or disposition of assets, any gain or loss is included in the consolidated statements of income.

We continually monitor events and changes in circumstances, which could indicate that the carrying balances of property, plant and equipment may exceed the undiscounted expected future cash flows from those assets. If such a condition were to exist, we will recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets.

Property, plant and equipment consisted of the following:

	March 31, 2004	December 31, 2003
Total cost	$ 2,670,000	$ 2,576,000
Accumulated depreciation	(682,000)	(603,000)
Net property, plant and equipment	$ 1,988,000	$ 1,973,000

Intangible Assets and Goodwill

Costs incurred to establish and defend patents, trademarks and licenses and to acquire products and process technologies are capitalized and amortized over their estimated useful lives. Useful lives are based on our estimate of the period that the assets will generate revenue or otherwise productively support our business.

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Goodwill and other intangible assets with indeterminate lives are no longer subject to amortization but are tested for impairment annually or whenever events or changes in circumstances indicate that the asset might be impaired. Intangible assets with finite lives continue to be subject to amortization and any impairment is determined in accordance with SFAS No. 144. In our estimate, no provision for impairment is currently required on any of our intangible assets or goodwill. We recorded amortization expense for the three months ended March 31, 2004 and March 31, 2003 of $63,000 and $6,000, respectively.

The following table presents details of our intangible assets, related accumulated amortization and goodwill. Other intangible assets consist of acquired customer lists and a non-compete agreement.

	As of December 31, 2003			As of March 31, 2004		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Patents (10 years)	$ 1,284,000	$ (150,000)	$ 1,134,000	$ 1,284,000	$ (183,000)	$ 1,101,000
Trademarks (6 years)	69,000	(60,000)	9,000	69,000	(63,000)	6,000
Trade names (Indefinite life)	979,000		979,000	979,000		979,000
Other (4 to 6 years)	523,000	(58,000)	465,000	593,000	(85,000)	508,000
Total	$ 2,855,000	$ (268,000)	$ 2,587,000	$ 2,925,000	$ (331,000)	$ 2,594,000
Goodwill (Indefinite life)	$ 2,926,000		$ 2,926,000	$ 2,926,000		$ 2,926,000

Non-operating (loss) income, net

Non-operating (loss) income, net consists of interest income and expense and foreign currency gains and losses. The operations and cash flows of our German subsidiary, are translated to U.S. dollars at average exchange rates during the period and its assets and liabilities are translated the end-of-period exchange rates. Translation gains or losses related to the net assets located in Germany are shown as a component of accumulated other comprehensive (loss) income in stockholders equity. Foreign currency gains or losses relating to sales and purchase transactions which are denominated in other than U.S. dollars are shown as a net gain or loss in the consolidated statements of income.

The following table presents details of non-operating (loss) income, net:

	Three Months Ended March 31,	
	2004	2003
(Loss) gain on foreign currency transactions	$ (47,000)	$ 46,000
Gain on forward exchange contract		22,000
Interest income	7,000	5,000
Interest expense	(21,000)	(19,000)
	$ (61,000)	$ 54,000

New Accounting Pronouncements

In December 2003, the FASB issued FASB Interpretation No. 46R, Consolidation of Variable Interest Entities (FIN 46R). FIN 46R requires the application of either FIN 46 or FIN 46R by Public Entities to all Special Purpose Entities (SPE) created prior to February 1, 2003 as of December 31, 2003 for calendar year-end companies. FIN 46R is applicable to all non-SPEs created prior to February 1, 2003 at the end of the first interim or annual period ending after March 15, 2004. For all entities created subsequent to January 31, 2003, Public Entities were required to apply the provisions of FIN 46R. The adoption of FIN 46R did not have an impact to our consolidated financial position, results of operations or cash flows.

NOTE 3 RESTATEMENT OF FINANCIAL STATEMENTS

On May 20, 2005, we announced the restatement of our consolidated financial statements for the years ended December 31, 2003 and 2002, the four quarters of 2003, and the first, second and third fiscal quarters of 2004. The unaudited consolidated financial statements included in this Form 10-Q/A for the three months ended March 31, 2004 and 2003 are restated to correct for the following errors:

Adjustments Impacting Stockholders Equity or Net Income

Revenue

During the fourth quarter of 2003, we did not identify all revenue transactions that contained a training element to be performed after product shipment. This resulted in us recognizing revenue before we had performed the related services and resulted in an overstatement of revenue in the period the product was shipped. As a result, we decreased revenue for the undelivered training that had not been performed during the first quarter of 2004 and recognized revenue for training that had been performed during the first quarter of 2004, which had originally been recorded as a reduction to sales and marketing expense. There were no adjustments for the first quarter of 2003.

During the first quarter of 2004, we improperly recognized revenue on consumables that had not been shipped as of March 31, 2004. As a result, we have reduced revenue and increased deferred revenue for the first quarter of 2004.

During the fourth quarter of 2003, we did not identify a Waterlase system that was not fully functional at the time of shipment, which resulted in the overstatement of revenue and cost of revenue. As a result, we decreased revenue and cost of revenue in the fourth quarter of 2003 and recognized the revenue and cost of revenue in the first quarter of 2004 when the final part required for functionality was delivered.

Cost of revenue

During the first quarter of 2004, we increased our excess and obsolete reserve for items that had previously been reserved.

General and administrative expense

Sales tax liability, related penalties and interest, and gains recognized on the abatement of certain penalties and interest

We charged our customers sales tax on purchases, but were late in filing sales tax returns and remitting amounts collected to certain states from 1998 to 2004. Additionally, the sales tax liability we recorded was understated. In accordance with the applicable accounting rules we are required to accrue, as a liability, interest and penalties under the applicable statutes, on late filings for which payment of sales tax has not been made. We have restated the consolidated financial statements for the first quarter of 2004 and 2003 to accrue these penalties and interest as a liability and to adjust for the under accrual of sales tax expense. During the first quarter of 2004, we reached agreements with certain states and were relieved from our liability to pay certain of the penalties and interest. Accordingly, we recognized a gain for the difference between the amount of penalties and interest that we had accrued as a liability and the amount we will pay to those states.

Value-added tax

We determined that certain refunds previously claimed on our value-added tax (VAT) returns and refunds recorded as a reduction of our VAT liability would be disallowed due to the improper collection of value-added tax information required at the time of product shipment. As a result, we increased our operating expense to properly reflect our liability for these items for the first quarter of 2004 and 2003.

Employee compensation

During the first quarter of 2004, we did not record certain payroll and commission expenses and over accrued health and dental insurance and our bonus expense. During the first quarter of 2003, we under accrued bonus and vacation expense and we over accrued payroll expense for general and administrative personnel.

Other

During 2002, we identified but did not originally record adjustments determined to be immaterial individually and in the aggregate.

During the first quarter of 2004, we wrote off a receivable for a service part that was never delivered. We reduced the revenue in the third quarter of 2003, and in the first quarter of 2004 eliminated the write off related to this service part.

Income Taxes

The provision for income taxes has been revised to reflect the impact of the errors listed above. For the first quarter of 2003, the tax provision was zero due to the uncertainty regarding the realizability of deferred tax assets. As a result, the impact for the errors resulted in a benefit against which a full valuation allowance was recorded. For the first quarter of 2004, the annual effective tax rate was applied to the as restated income before income taxes resulting in a reduced provision for income taxes and an increase in deferred tax assets. We also increased deferred tax assets for the stock option deduction benefit recorded to additional paid-in-capital for options exercised in the first quarter of 2004.

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

The net effect of these errors is to increase revenue by $26,000 and zero, to increase cost of revenue by $23,000 and $31,000, and to increase operating expenses by $88,000 and $16,000, for the first quarter of 2004 and 2003, respectively. The provision for income taxes has been revised to reflect the impact of these adjustments.

The following table is a reconciliation of net income as previously reported to amounts as restated for the periods indicated:

	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
Net income, as previously reported	$ 672,000	$ 940,000
Adjustments to revenue:		
Undelivered training element	(75,000)	
Training performed	98,000	
Consumables not shipped	(52,000)	
Product delivered	55,000	
Total revenue related adjustments	26,000	
Adjustments to cost of revenue:		
Employee compensation	18,000	(16,000)
Inventory	(33,000)	
Product delivered	(8,000)	
Other		(15,000)
Total cost of revenue related adjustments	(23,000)	(31,000)
Adjustments to sales and marketing expense:		
Employee compensation	(24,000)	
Other		(27,000)
Total sales and marketing expense related adjustments	(24,000)	(27,000)
Adjustments to general and administrative expense:		
Sales tax	(40,000)	(66,000)
Penalties and interest on sales tax	(47,000)	(52,000)
Gain on abatement of penalties	62,000	
Value-added tax	(15,000)	
Employee compensation	(31,000)	64,000

Other	7,000	65,000
Total general and administrative expense related adjustments	(64,000)	11,000
Adjustments to income tax provision	29,000	
Restated net income	$ 616,000	$ 893,000
Net income per share (restated):		
Basic	$ 0.03	$ 0.04
Diluted	$ 0.03	$ 0.04

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Adjustments Not Impacting Stockholders Equity or Net Income

As of March 31, 2004, we have reclassified amounts from accrued liabilities to deferred revenue so that all deferred revenue items are included in the same balance sheet component. In addition, we reclassified our value added tax receivable included in prepaid expenses and other current assets as a reduction to our value added tax payable included in accrued liabilities. The adjustments not impacting stockholders equity as of December 31, 2003, including the adjustments to the balance sheets for prior periods, are more fully described in Note 3 to the consolidated financial statements filed in our Form 10-K with the SEC on the same date as this Form 10-Q/A has been filed.

We have corrected the presentation of certain amounts related to the training component included in our multiple element arrangements, which had incorrectly been classified as a reduction to sales and marketing expense when the training was performed, to revenue. We have corrected the presentation of the expenses for our training, which had incorrectly been classified as sales and marketing expense, to cost of revenue. Also, we corrected the presentation of the deferred gain on the sale of our building from net revenue to other income.

The following table sets forth selected consolidated balance sheet data, showing previously reported amounts, restatement adjustments not impacting stockholders equity and restatement adjustments impacting stockholders equity for the periods indicated.

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Consolidated Balance Sheet Data

	March 31, 2004			
	As Previously Reported	Adjustments Not Impacting Stockholders Equity	Adjustments Impacting Stockholders Equity	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 50,095,000	$	$	$ 50,095,000
Accounts receivable	6,205,000			6,205,000
Inventory	4,022,000		16,000	4,038,000
Deferred tax asset	1,079,000		429,000	1,508,000
Prepaid expenses and other current assets	1,117,000	(57,000)		1,060,000
Total current assets	62,518,000	(57,000)	445,000	62,906,000
Property, plant and equipment, net	1,988,000			1,988,000
Intangible assets, net	2,594,000			2,594,000
Goodwill	2,926,000			2,926,000
Deferred tax asset, net of current portion	12,241,000		1,232,000	13,473,000
Other assets	107,000			107,000
Total assets	$ 82,374,000	$ (57,000)	$ 1,677,000	$ 83,994,000
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Accounts payable	$ 2,024,000	$	$ (17,000)	$ 2,007,000
Accrued liabilities	4,967,000	(583,000)	800,000	5,184,000
Deferred revenue	490,000	526,000	265,000	1,281,000
Deferred gain on sale of building current portion	63,000			63,000
Total current liabilities	7,544,000	(57,000)	1,048,000	8,535,000
Deferred gain on sale of building	63,000			63,000
Total liabilities	7,607,000	(57,000)	1,048,000	8,598,000
Stockholders equity:				
Preferred stock				
Common stock	24,000			24,000
Additional paid-in capital	101,511,000		1,175,000	102,686,000
Accumulated other comprehensive loss	(159,000)			(159,000)
Accumulated deficit	(26,609,000)		(546,000)	(27,155,000)

Total stockholders equity	74,767,000		629,000	75,396,000
Total liabilities and stockholders equity	$ 82,374,000	$ (57,000)	$ 1,677,000	$ 83,994,000

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Consolidated Balance Sheet Data

	December 31, 2003			
	As Previously Reported	Adjustments Not Impacting Stockholders Equity	Adjustments Impacting Stockholders Equity	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 11,111,000	$	$	$ 11,111,000
Accounts receivable	5,771,000			5,771,000
Inventory	3,752,000		56,000	3,808,000
Deferred charges on products shipped	55,000	(55,000)		
Deferred tax asset	1,079,000		429,000	1,508,000
Prepaid expenses and other current assets	1,528,000	(268,000)		1,260,000
Total current assets	23,296,000	(323,000)	485,000	23,458,000
Property, plant and equipment, net	1,973,000			1,973,000
Intangible assets, net	2,587,000			2,587,000
Goodwill	2,926,000			2,926,000
Deferred tax asset, net of current portion	12,678,000		(27,000)	12,651,000
Other assets	1,041,000			1,041,000
Total assets	$ 44,501,000	$ (323,000)	$ 458,000	$ 44,636,000
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Line of credit	$ 1,792,000	$	$	$ 1,792,000
Accounts payable	3,590,000	223,000	(17,000)	3,796,000
Accrued liabilities	5,940,000	(1,111,000)	722,000	5,551,000
Customer deposits	223,000	(223,000)		
Deferred revenue	144,000	788,000	297,000	1,229,000
Deferred gain on sale of building current portion	63,000			63,000
Debt	888,000			888,000
Total current liabilities	12,640,000	(323,000)	1,002,000	13,319,000
Deferred gain on sale of building	79,000			79,000
Total liabilities	12,719,000	(323,000)	1,002,000	13,398,000
Stockholders equity:				
Preferred stock				
Common stock	22,000			22,000

Additional paid-in capital	59,188,000		(54,000)	59,134,000
Accumulated other comprehensive loss	(147,000)			(147,000)
Accumulated deficit	(27,281,000)		(490,000)	(27,771,000)
Total stockholders equity	31,782,000		(544,000)	31,238,000
Total liabilities and stockholders equity	$ 44,501,000	$ (323,000)	$ 458,000	$ 44,636,000

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

The following table sets forth selected consolidated statement of income data, showing previously reported amounts, restatement adjustments not impacting net income and restatement adjustments impacting net income for the periods indicated:

Consolidated Statement of Income Data

	Three Months Ended March 31, 2004			
	As Previously Reported	Adjustments Not Impacting Net Income	Adjustments Impacting Net Income	As Restated
Net revenue	$ 14,425,000	$ 79,000	$ 26,000	$ 14,530,000
Cost of revenue	5,138,000	525,000	23,000	5,686,000
Gross profit	9,287,000	(446,000)	3,000	8,844,000
Other income, net		16,000		16,000
Operating expenses:				
Sales and marketing	5,742,000	(430,000)	24,000	5,336,000
General and administrative	1,603,000		64,000	1,667,000
Engineering and development	772,000			772,000
Total operating expenses	8,117,000	(430,000)	88,000	7,775,000
Income from operations	1,170,000		(85,000)	1,085,000
Non-operating (loss) gain, net	(61,000)			(61,000)
Income before income taxes	1,109,000		(85,000)	1,024,000
Provision for income taxes	(437,000)		29,000	(408,000)
Net income	$ 672,000	$	$ (56,000)	$ 616,000
Net income per share:				
Basic	$ 0.03	$	$	$ 0.03
Diluted	$ 0.03	$	$	$ 0.03

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Consolidated Statement of Income Data

	Three Months Ended March 31, 2003			
	As Previously Reported	Adjustments Not Impacting Net Income	Adjustments Impacting Net Income	As Restated
Net revenue	$ 9,214,000	$ (16,000)	$	$ 9,198,000
Cost of revenue	3,347,000		31,000	3,378,000
Gross profit	5,867,000	(16,000)	(31,000)	5,820,000
Other income, net		16,000		16,000
Operating expenses:				
Sales and marketing	3,625,000		27,000	3,652,000
General and administrative	844,000		(11,000)	833,000
Engineering and development	512,000			512,000
Total operating expenses	4,981,000		16,000	4,997,000
Income from operations	886,000		(47,000)	839,000
Non-operating (loss) gain, net	54,000			54,000
Income before income taxes	940,000		(47,000)	893,000
Provision for income taxes				
Net income	$ 940,000	$	$ (47,000)	$ 893,000
Net income per share:				
Basic	$ 0.05	$	$ (0.01)	$ 0.04
Diluted	$ 0.04	$	$	$ 0.04

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

The following table sets forth selected consolidated statement of cash flow data showing previously reported amounts and restated amounts for the periods indicated:

Consolidated Statements of Cash Flows Data

	Three Months Ended March 31,			
	2004	2004	2003	2003
	As Previously Reported	Restated	As Previously Reported	Restated
Cash Flows From Operating Activities:				
Net income	$ 672,000	$ 616,000	$ 940,000	$ 893,000
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Depreciation and amortization	146,000	146,000	65,000	65,000
Gain on disposal of assets	(16,000)	(16,000)	(16,000)	(16,000)
Gain on foreign exchange contract			(22,000)	(22,000)
Provision for uncollectible accounts	17,000	17,000	148,000	148,000
Provision for inventory obsolescence	29,000	29,000	107,000	107,000
Deferred tax asset	437,000	407,000		
Changes in assets and liabilities:				
Accounts receivable	(451,000)	(451,000)	1,001,000	1,002,000
Inventory	(299,000)	(259,000)	(1,005,000)	(990,000)
Prepaid expenses and other assets	1,400,000	1,134,000	458,000	610,000
Accounts payable and accrued liabilities	(2,334,000)	(2,140,000)	(829,000)	(685,000)
Deferred revenue	(82,000)	36,000	(551,000)	(595,000)
Net cash (used in) provided by operating activities	(481,000)	(481,000)	296,000	517,000
Cash Flows From Investing Activities:				
Additions to property, plant and equipment	(134,000)	(134,000)	(39,000)	(39,000)
Business acquisition	(70,000)	(70,000)		
Net cash used in investing activities	(204,000)	(204,000)	(39,000)	(39,000)
Cash Flows From Financing Activities:				
Payment on line of credit	(1,792,000)	(1,792,000)		
Payments on insurance notes	(888,000)	(888,000)		(156,000)

Proceeds from issuance of common stock, net of expenses	41,877,000	41,877,000		
Proceeds from exercise of stock options and warrants	448,000	448,000	1,640,000	1,640,000
Net cash provided by financing activities	39,645,000	39,645,000	1,640,000	1,484,000
Effect of exchange rate changes on cash	24,000	24,000	(26,000)	(26,000)
Net increase in cash and cash equivalents	38,984,000	38,984,000	1,871,000	1,936,000
Cash and cash equivalents at beginning of period	11,111,000	11,111,000	3,940,000	3,875,000
Cash and cash equivalents at end of period	$ 50,095,000	$ 50,095,000	$ 5,811,000	$ 5,811,000

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

NOTE 4 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable includes $51,000 and $223,000 of customer deposits at March 31, 2004 and December 31, 2003 respectively.

Components of accrued liabilities were as follows:

	March 31, 2004 Restated	December 31, 2003 Restated
Payroll and benefits	$ 1,811,000	$ 2,090,000
Warranty expense	813,000	727,000
Sales tax	1,708,000	1,418,000
Amounts due to customers	301,000	205,000
Professional services	385,000	574,000
Other	166,000	537,000
Total accrued liabilities	$ 5,184,000	$ 5,551,000

We reimburse our customers for their costs related to certain marketing programs. On our purchase orders we state the amount that we will reimburse the customers, which is recorded as a reduction of revenue when revenue of the purchase order is recognized. Amounts due to customers represent our obligation to reimburse our customers for these programs.

NOTE 5 ACQUISITION

On May 21, 2003, we acquired the American Dental Laser (ADL) assets from American Medical Technologies, Inc. (AMT) for approximately $5.8 million, in order to leverage our marketing, strengthen our portfolio of intellectual property and expand our product lines. The assets acquired included inventory, dental laser patents, customer lists, brand names and other intellectual property, as well as laser products. No liabilities of AMT were assumed in the transaction. The consideration paid by us consisted of approximately $1.8 million in cash, $215,000 in transaction costs directly attributable to the acquisition and 308,000 shares of common stock with a fair value of approximately $3.8 million. For purposes of computing the purchase price, the value of the common stock of $12.38 per share was determined by taking the average closing price of our common stock as quoted on NASDAQ between May 19, 2003 and May 23, 2003. The total purchase price has been allocated to the acquired tangible and intangible assets of ADL based on the fair values with the balance allocated to goodwill. The acquisition was accounted

for as a purchase under SFAS No. 141, Business Combinations. The amount allocated to the intangible assets was determined using estimates of discounted cash flow for the patents, trademarks, trade name and non-competition agreement; and the cost approach was used to estimate the value of the customer list. The total intangible assets acquired include approximately $2.9 million for goodwill (which is deductible for tax purposes), $979,000 for trade names and trademarks, $1.2 million for patents, $432,000 for a customer list and $91,000 for a non-compete agreement. The patents are being amortized over ten years, the customer list over six years, and the non-compete agreement over four years. The trademarks and trade names were determined to have indefinite lives.

The total consideration consisted of the following:

Cash	$ 1,825,000
Stock consideration (308,000 shares at $12.38 per share)	3,806,000
Acquisition costs	215,000
Total	$ 5,846,000

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

The components of the purchase price and allocation are as follows:

Tangible assets acquired	$ 246,000
Identifiable intangible assets acquired	2,674,000
Goodwill	2,926,000
Total	$ 5,846,000

The following unaudited data summarizes the results of operations for the period indicated as if the ADL acquisition had been completed as of the beginning of the period presented. The pro forma data gives effect to actual operating results prior to the acquisition, adjusted to include the pro forma effect of amortization of identifiable intangible assets:

	Three Months Ended March 31, 2003 Restated
Pro forma:	
Net revenue	$ 9,610,000
Net income	730,000
Net income per share:	
Basic	$ 0.04
Diluted	$ 0.03

In January 2004, we acquired PAClive, a continuing education program for dentists, from Discus Dental, Inc. for $70,000. The assets acquired were trademarks and a customer list along with minor equipment and supplies. We have recorded this acquisition as an increase in intangible assets with a useful life of five years.

NOTE 6 STOCKHOLDERS EQUITY

In March 2004, as a result of the completion of a public underwritten offering, we issued 2,500,000 shares of common stock at an offering price of $18.50 per share. Gross proceeds from the offering were $46,250,000, before underwriting discount of $2,875,000. In connection with the offering, we incurred direct expenses of $1,498,000, which had been included in other assets and were reclassified as a reduction of additional paid-in capital when the common stock was issued.

Shares issued as a result of stock option exercises for the three months ended March 31, 2004 totaled 195,000 which resulted in proceeds of $448,000.

NOTE 7 COMPREHENSIVE INCOME

Components of comprehensive income were as follows:

	Three Months Ended	
	March 31, 2004 Restated	March 31, 2003 Restated
Net income	$ 616,000	$ 893,000
Other comprehensive (loss) income items:		
Foreign currency translation adjustments	(12,000)	(26,000)
Comprehensive income	$ 604,000	$ 867,000

NOTE 8 INCOME TAXES

As of December 31, 2003, the valuation reserves on our deferred tax assets were reduced and we recognized an income tax benefit and established deferred tax assets of $14.2 million. For the three months ended March 31, 2004, we have recorded a provision for income tax expense of $408,000 (restated) with a corresponding reduction of deferred tax assets. Income taxes will not be payable, subject to any alternative minimum tax, until we have utilized our net operating loss carryforwards, which were approximately $32.4 million (restated) as of December 31, 2003. For the three months ended March 31, 2003, we did not record a provision for income tax expense since we had not determined at that time that the realization of our deferred tax assets was more likely than not.

Table of Contents

BIOLASE TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

NOTE 9 COMMITMENTS AND CONTINGENCIES

Leases

We lease our manufacturing facilities in San Clemente, California, certain equipment and automobiles under operating lease arrangements. Future minimum rental commitments under operating leases as of March 31, 2004 for each of the years ending December 31 are as follows:

	Restated
Remainder of 2004	$ 389,000
2005	510,000
2006	92,000
2007	8,000
2008	1,000
Total	$ 1,000,000

The future minimum rentals have been increased by $207,000 to restate for commitments that had been improperly excluded.

Litigation

We are currently involved in a patent lawsuit with Diodem, LLC, a California limited liability company. The claims in this lawsuit were originally part of two separate lawsuits in U.S. District Court. On May 2, 2003, we initiated a civil action in the U.S. District Court for the Central District of California against Diodem. In this lawsuit we are seeking a judicial declaration against Diodem that technology we use in laser systems does not infringe four patents owned by Diodem. Diodem claims to have acquired the four patents at issue in the case from Premier Laser. In 2000, we initiated patent infringement lawsuit against Premier Laser seeking damages and to prevent Premier from selling competing dental lasers on the grounds that they infringed on certain of our patents. The lawsuit was stayed by the bankruptcy court after Premier filed for bankruptcy.

In response to our lawsuit against Diodem, on May 5, 2003, Diodem added us as a party to an infringement lawsuit it had previously filed in the U.S. District Court for the Central District of California. The other parties to this lawsuit are American Medical Technologies, Inc. (AMT), Lumemis and its subsidiary OpusDent, Ltd., and Hoya Photonics and its subsidiary Hoya ConBio. OpusDent and Hoya ConBio manufacture and

sell dental lasers pursuant to patents originally licensed to them by AMT. We acquired the licensed patents and related license agreements in our acquisition of the American Dental Laser assets from AMT. In July 2003, AMT was dismissed from the lawsuit without prejudice; however, we and other defendants remain in the suit.

Diodem s lawsuit against us alleges that our Waterlase product infringes upon the four patents that Diodem acquired from Premier Laser. Diodem also alleges that the products sold by OpusDent and Hoya ConBio also infringe upon the patents. Diodem s infringement suit seeks treble damages, a preliminary and permanent injunction from further alleged infringement, attorneys fees and other unspecified damages. If Diodem successfully asserts an infringement claim against us, our operations may be significantly impacted, especially to the extent that it affects our right to use the technology incorporated in our Waterlase system, which accounted for approximately 77% of our revenue in the first quarter of 2004 and approximately 83% of our revenue for the year ended December 31, 2003. If Diodem successfully asserts an infringement claim against Hoya ConBio and OpusDent, it could reduce or eliminate royalties we might receive under licenses to those products, which have totaled approximately $372,000 since the acquisition of the American Dental Laser assets in May 2003. Both of these lawsuits are in their preliminary stages, and may proceed for an extended period of time. Although the outcome of these actions cannot be determined with any certainty, we believe our technology and products do not infringe any valid patent rights owned by Diodem, and we intend to continue to vigorously defend against Diodem s infringement action and pursue our declaratory relief action against Diodem. No amounts have been recorded in the consolidated financial statements relating to the outcome of this matter.

From time to time, we are involved in other legal proceedings incidental to our business. We believe that our pending actions, individually and in the aggregate, will not have a material adverse effect on our financial condition, results of operations or cash flows.

Securities and Exchange Commission Inquiry

Following the restatement of our financial statements in September 2003, we received, in late October 2003, and subsequently in 2003 and 2004, informal requests from the SEC to voluntarily provide information relating to the restatement. We have provided information to the SEC and, if we receive any additional requests, we would cooperate in responding. In accordance with its normal practice, the SEC has not advised us if its inquiry has been concluded.

NOTE 10 CONCENTRATIONS

Many of our customers finance their purchases through third-party leasing companies. In these transactions, the leasing company is considered the purchaser, although it is the dentist who is our customer and to whom we market and sell and from whom we receive the initial binding purchase commitment. Approximately 37% and 30% of our revenue for the three months ended

Table of Contents

March 31, 2004 and March 31, 2003, respectively, were generated from customers who financed their purchase through one leasing company. Other than these transactions, no distributor or customer accounted for more than 10% of consolidated net revenue for the three months ended March 31, 2004 and March 31, 2003.

Financial instruments that subject us to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. We maintain our cash accounts with established commercial banks. Such cash deposits periodically exceed the Federal Deposit Insurance Corporation insured limit of $100,000 for each account.

Accounts receivable concentrations have resulted from sales activity to the one leasing company mentioned above. Accounts receivable for the one leasing company totaled $815,000 and $428,000, respectively, at March 31, 2004 and March 31, 2003. No other single customer accounted for more than 10% of our accounts receivable at March 31, 2004 or March 31, 2003.

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

Cautionary Statement With Respect To Forward-looking Information

You should read the following discussion and analysis in conjunction with our Unaudited Consolidated Financial Statements and related Notes thereto contained elsewhere in this quarterly report on Form 10-Q/A (the Report). The information contained in this Report is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this Report and in our other reports filed with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the year ended December 31, 2004, and other filings that discuss our business in greater detail. This Report contains forward-looking statements that can often be identified by words such as anticipates, expects, intends, plans, believes, seeks, estimates, will, should, would, potential, continue, and variations of these words or similar expressions. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. Examples of these forward-looking statements include, but are not limited to, statements concerning the application of our technology, the potential of our market and our position in it, our manufacturing capacity, estimates concerning asset valuation and loss contingencies and expectations concerning future costs and cash flow, and our ability to successfully finance our business or replace existing loans. These forward-looking statements are based on our current expectations, estimates and projections about our industry, and reflect our beliefs and certain assumptions made by us. These statements speak only as of the date of this Report and are based upon the information available to us at this time. Such information is subject to change, and we will not necessarily inform you of such changes. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors, some of which are set forth in Risk Factors, below. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

Restatement of Financial Statements

The following discussion and analysis gives effect to the restatements described in the Explanatory Note to this Form 10-Q/A and in Note 3 to our unaudited consolidated financial statements contained herein. Accordingly, certain of the data set forth in this section is not comparable to discussions and data in our previously filed annual and quarterly reports for the corresponding periods.

Critical Accounting Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect the amounts reported. See the discussion of significant accounting policies in our Annual Report on Form 10-K for the year ended December 31, 2004 as well as the Summary of Significant Accounting Policies in Note 2 to the unaudited Consolidated Financial Statements included in this report. For the quarter ended March 31, 2004 there were no unusual uncertainties of a material nature involved in the application of these principles nor any unusual, material variation in estimates related to these principles.

Overview

We are one of the world s leading dental laser companies. We design, manufacture and market proprietary dental laser systems that are designed to allow dentists, oral surgeons and other specialists to perform a broad range of common dental procedures, including cosmetic applications. Our systems provide superior performance for many types of dental procedures, with less pain and faster recovery times than are generally achieved with drills and other dental instruments. We have clearance from the U. S. Food and Drug Administration to market our laser systems in the United States. We also have the approvals necessary to sell our laser systems in Canada, the European Union and other international markets. Since 1998, we have sold more than 2,000 laser systems in over 20 countries.

We have the following product lines: (i) Waterlase system; (ii) LaserSmile system; (iii) American Dental Laser products, including the Diolase, the new Diolase Plus and Pulsemaster® systems, and (iv) related accessories and disposables for use with our laser systems. Our principal product, the Waterlase system, is used for hard and soft tissue dental procedures, and can be used to perform most procedures currently performed using dental drills, scalpels and other traditional dental instruments. The LaserSmile

Table of Contents

system is used for a range of soft tissue procedures and tooth whitening. The Diolase, Diolase Plus and Pulsemaster systems are primarily used for soft tissue procedures. We also manufacture and sell accessories and disposables, such as handpieces, laser tips and tooth whitening gel, for use with our dental laser systems.

In January 2004, we acquired PAClive from Discus Dental, Inc. for $70,000. Assets received include trademarks and a customer list, which were recorded as an increase to intangible assets. PAClive is one of the leading live-patient, hands-on continuing education programs in the United States and is well known in the industry for advancing dentistry to the benefit of both practitioners and patients. The addition of PAClive is part of our commitment to education as a means of demonstrating the benefits of lasers in dentistry.

In February 2004, we received clearance from the Food and Drug Administration for several new bone, periodontal and soft tissue procedures: osteoplasty and osseous recontouring (removal of bone to correct osseous defects and create physiologic osseous contours); ostectomy (resection of bone to restore bony architecture, resection of bone for grafting, etc); osseous crown lengthening; flap preparation incision of soft tissue to prepare a flap and expose unerupted teeth (hard and soft tissue impactions); full thickness flap; partial thickness flap; split thickness flap; removal of granulation tissue from bony defects; and laser soft tissue curettage of the post-extraction tooth sockets and the periapical area during apical surgery. Additionally, we received clearance for our Waterlase system to perform soft tissue curettage. Our LaserSmile diode laser was previously cleared for laser soft tissue curettage in October 2003.

In March 2004, we leased additional office and manufacturing space next door to our headquarters in San Clemente, California. This facility gives us added capacity in manufacturing, customer support, and marketing to support our continued growth. This move brings our leased facilities in the U.S. to approximately 40,000 sq. ft. in addition to 20,000 sq. ft. of space we own in Germany.

Three months ended March 31, 2004 (restated) compared with three months ended March 31, 2003 (restated)

The first quarter of 2004 saw a continuation of the strong increase in demand that we have been experiencing, with sales increasing 58% over the first quarter of 2003. Our priority continues to be on market penetration, which we believe is crucial given the large size of the potential market (over 500,000 practicing dentists in the developed countries of the world), the low penetration of laser technology, which we believe to be less than 2%, and our current position as one of the market leaders. As a result of the strong sales in the first quarter, we now expect sales for 2004 to be in the range of $69.0 million to $72.0 million, compared to $49.0 million in 2003.

The completion of our public offering of 2.5 million shares resulted in net proceeds of approximately $43.4 million and strengthened our financial position and liquidity. We intend to use this capital over the next several years to support our continued growth.

Operating income improved by 29% to $1.1 million compared to $839,000 for the first quarter of 2004 and 2003, respectively, despite greater general and administrative expenses which were due to our overall growth and to higher legal and accounting fees as well as higher insurance costs. Legal fees include costs related to the Diodem patent litigation. While the legal costs of this litigation did affect our operating margin this quarter, we believe that our technology and products do not infringe any valid patent rights owned by Diodem and we intend to vigorously defend against Diodem s infringement claims and pursue our claims against Diodem.

Net income of $616,000, or $0.03 per diluted share, included a provision for income tax expense of $408,000 as a result of reducing the valuation reserves on our deferred tax assets in the previous quarter. Income taxes will not be payable, subject to alternative minimum tax, until

we have utilized our net operating loss carryforwards, which were approximately $32.4 million as of December 31, 2003. Net income for the first quarter of 2003 was $893,000, or $0.04 per diluted share, without a provision for income tax.

Table of Contents

Results of Operations (restated)

The following table sets forth comparative statements of income data ($000):

	Restated				Percent of Revenue	
	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003	Increase (Decrease)	Percent Increase (Decrease)	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
Net revenue	$ 14,530	$ 9,198	$ 5,332	58.0%	100.0%	100.0%
Cost of revenue	5,686	3,378	2,308	68.3	39.1	36.7
Gross profit	8,844	5,820	3,024	52.0	60.9	63.3
Other income	16	16			0.1	0.2
Operating expenses:						
Sales and marketing	5,336	3,652	1,684	46.1	36.7	39.7
General and administrative	1,667	833	834	100.1	11.5	9.1
Engineering and development	772	512	260	50.8	5.3	5.6
Total operating expenses	7,775	4,997	2,778	55.6	53.5	54.4
Income from operations	1,085	839	246	29.3	7.5	9.1
Non-operating (loss) income	(61)	54	(115)	(213.0)	(0.4)	0.6
Income before tax	1,024	893	131	14.7	7.1	9.7
Provision for income tax	(408)		(408)		(2.8)	
Net income	$ 616	$ 893	$ (277)	(31.0)	4.3	9.7

Sales of lasers were seasonally slower in the first quarter of 2004 than the preceding fourth quarter of 2003, in line with our historical pattern of seasonality. In 2003, first quarter sales accounted for only 19% of total sales. However, sales for the first quarter of 2004 increased 58% over the first quarter of 2003 continuing a trend of quarter over prior year same quarter increases in excess of 50% for twelve of the past fourteen quarters and average increases in excess of 50% quarter over prior year same quarter since 1999.

Both domestic and international sales grew at approximately the same rate with domestic sales comprising approximately 81% of total sales for both the first quarter of 2004 and the first quarter of 2003. For the year, however, we expect international sales to increase relative to domestic sales.

Product mix also stayed relatively constant. Sales of our Waterlase system accounted for approximately 77% of sales for the first quarters of 2004 and 2003. For the year ended December 31, 2003 Waterlase system sales were 83%. We expect that our Waterlase system will continue to account for approximately 80% of total sales again for 2004.

Significant estimates affecting sales include the reserve for sales returns. The reserve is based on historical experience from 1998 through the present. Due to positive experience in the first quarter, the reserve decreased from $327,000 to $247,000.

Gross margin increased by 52% in the first quarter of 2004 aided by higher levels of sales but offset by increases in our cost structure from 2003. Gross margin decreased from 63% to 61% from the first quarter of 2003 to the first quarter of 2004, as a result of higher production costs and the costs of training associated with our multiple element arrangements which are classified as cost of revenue. Training negatively impacted gross margins for the first quarter of 2004 by 3%. Our manufacturing cost structure, except for the cost of materials, is relatively fixed. We expect that as the rate of sales increases for the balance of 2004, gross margin should improve as result of operating leverage. However, if international sales increase relative to domestic sales, as we expect they will, this will work to offset increases in gross margin from operating leverage because we sell to international dealers at a discount to compensate for sales and marketing expenses which they must incur. Our expectation is that for 2004 gross margin will remain consistent with the gross margin reported for the first quarter of 2004. Significant estimates affecting gross margin include the allowance for inventory obsolescence and accrued warranty expense. During the first quarter of 2004, the allowance for inventory obsolescence remained relatively unchanged. The provision for warranty expense was $253,000 in first quarter of 2004 compared to $290,000 for the first quarter of 2003. Gross margin is also affected by the reserve for sales returns which decreased from $327,000 at December 31, 2003 to $247,000 at March 31, 2004.

Sales and marketing expenses increased 46% compared to a 58% increase in net revenue. While some of our sales and marketing costs are fixed, most are discretionary expenditures aimed at furthering our market penetration and positioning us for sustained long-term growth. Therefore, we do not reduce our discretionary expenditure level to match the short-term, anticipated seasonal slowdown in sales associated with the first quarter. Approximately one-third of the increase in absolute dollars for the first quarter of 2004 compared to the first quarter of 2003 is directly related to higher commission expenses on higher sales. Another third of the increase is due to the increase in sales staff, both domestic and international. As of March 31, 2004, we had 32 direct sales staff in North America and eight direct sales staff covering Europe. Although not a direct driver of cost increase, the increase in our international distributorships to 34 represents a significant increase since March 31, 2003 and broadens the foundation

Table of Contents

for future sales growth. Additions to our marketing infrastructure and increases in our participation in domestic and international trade shows and other sales events account for the final third of the cost increase in sales and marketing expenses.

Although we believe we are one of the market leaders in our industry, we must invest not only in traditional marketing but also in education to accomplish the paradigm shift that we seek. This is the reason we formed the World Clinical Laser Institute (WCLI) and why we continually seek to form alliances with teaching programs in the U.S. and globally. The WCLI is now the world s largest teaching institute for laser dentistry. In the first quarter of 2004, the WCLI held its largest ever conference with over 650 participants and over the course of 2004, through an additional six conferences, expects to reach a participation level of 1,500 of existing and potential customers as well as researchers and academicians. Although we charge tuition to customers to offset the cost of these conferences (included in revenue), the increasing number and size of WCLI conferences represents a substantial cost to us, a portion of which is included in cost of revenue and a portion of which is included in sales and marketing expense.

In 2003, we began piloting consumer marketing campaigns in California and other selected markets in the U.S. These pilots often involve a sharing of cost on the part of participating customers. Based on the positive feedback we have received, we intend to continue these pilots and may increase these efforts depending on the results achieved.

Sales and marketing expense as a percentage of sales was 36.7% and 39.7% for the quarters ended March 31, 2004 and 2003 respectively. Sales and marketing expense as a percentage of sales for 2001, 2002 and 2003 were 44.2%, 39.3% and 34.4%. However, sales for the first quarter of 2003 and for the years ended December 31, 2001, 2002 and 2003 were primarily on a cash basis whereas sales for the first quarter of 2004 were on an accrual basis. In order to properly assess the trend in sales and marketing expense as a percent of sales, we believe that a comparison of sales and marketing expense as a percentage of gross sales value (defined as actual units shipped multiplied by actual unit sales price) would provide a clearer picture of the trend in sales and marketing expense. Using this non-GAAP metric, sales and marketing expense as a percentage of gross sales value was 42.2% for the first quarter of 2003 and was 40.9%, 36.7% and 36.5% for the years ended December 31, 2001, 2002 and 2003 respectively. We expect that for 2004, sales and marketing expense will average approximately 35% of sales.

The level of general and administrative expenses was similar to that incurred in the previous two quarters, but represented a $834,000 or 100% increase over the first quarter of 2003. Major cost increases for the first quarter of 2004 compared to the first quarter of 2003 were legal fees, including legal fees related to the Diodem patent litigation, payroll expense, sales tax expense, audit fees and insurance costs and relate in many ways to our overall growth. Increases in these cost categories totaled approximately $767,000. The increase in our general and administrative expenses were offset by the $62,000 gain recorded on the abatement of penalties on sales tax during the three months ended March 31, 2004. We expect to continue to incur significant costs in these categories; and although the duration and amount of cost related to litigation is not predictable, we do not expect general and administrative expenses to vary appreciably for the remaining three quarters of 2004.

Engineering and development expenses include engineering personnel salaries, prototype supplies and contract services. Engineering and development expense for the three months ended March 31, 2004 increased 51% from the first quarter of 2003, consistent with the growth in net sales. Increases are due to increased levels of activity in product development. We expect to further increase our spending in product development during the remainder of 2004 and anticipate that total spending in this category will average between 5% and 6% of net sales for 2004.

We experienced a non-operating loss of $61,000 for the first quarter of 2004 compared to a non-operating gain of $54,000 for the first quarter of 2003. Interest income and interest expense did not change materially. However, in the first quarter of 2003, we recognized a gain of $22,000 on a forward contract that ended. Also, in the first quarter of 2003, we had a foreign currency transaction gain of $46,000 compared to a foreign currency transaction loss of $47,000 in the first quarter of 2004. Due to the relatively low volume of transactions denominated in currencies other than the U.S. dollar, we have not engaged in hedging transactions to offset foreign currency fluctuations. Therefore, we are at risk for

changes in the value of the dollar relative to the value of the euro, which is the only non-U.S. dollar denominated currency in which we have transacted business.

With the completion of our public offering in March 2004 and the subsequent investment of proceeds in short-term investment grade securities, we anticipate that interest income will increase materially during the remainder of 2004.

For the year ended December 31, 2003, we recorded an income tax benefit of $11.9 million as a result of reducing the valuation allowance on deferred tax assets which was included in our consolidated statements of income and an income tax benefit for the exercise of stock options of $2.2 million which was recorded to additional paid-in capital. The deferred tax assets consist primarily of net operating loss carryforwards. They had been fully reserved in prior periods due to the uncertainty of whether we would generate sufficient taxable income to realize the benefits of the assets. Based upon the level of our historical taxable income and the projection for future taxable income, we concluded that it was more likely than not that we would realize the benefits of these assets. In the first quarter of 2004, we recorded a provision for income tax expense of $408,000 with a corresponding reduction of deferred tax assets. There was no provision for income tax expense in the first quarter of 2003 due to the uncertainty at that time of whether we would generate sufficient taxable income to realize the benefits of the deferred tax assets. Although we will now record an accounting charge to measure the tax expense on taxable income, income taxes will not be payable, subject to any alternative minimum tax until we have utilized our net operating loss carryforwards, which were approximately $32.4 million at December 31, 2003.

Table of Contents

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2004, we had approximately $54.4 million in net working capital, an increase of $44.2 million from $10.2 million at December 31, 2003. Our principal source of liquidity at March 31, 2004 consisted of our cash balance of $50.1 million. For the three months ended March 31, 2004, our sources of cash were net proceeds of $43.4 million from our public offering and $448,000 from the exercise of stock options. During the quarter, we paid off our line of credit of $1.8 million and our insurance notes of $888,000. We also temporarily reduced our vendor payables by $1.8 million. Including the pay down in accounts payable, cash used in operations for the quarter was $481,000. For further details see the Unaudited Consolidated Statements of Cash Flows included in this Report.

Accounts receivable increased 8% or $434,000 in the first quarter and inventory increased 6% or $230,000. Days sales in receivables for the quarter averaged approximately 38 and inventory turnover averaged approximately 5.8.

On March 3, 2004, we completed a public offering of 2.5 million shares of common stock. Proceeds net of underwriting discount of $2.9 million were $43.4 million. We also incurred legal, accounting and related costs of approximately $1.5 million which we had capitalized in Other Assets. At the time of closing, we reclassified these capitalized costs from Other Assets to Additional Paid-in Capital. We expect to use the net proceeds of the offering for general corporate purposes, working capital, repayment of debt (which has been completed) and capital expenditures, including expenditures for expansion of our production capabilities, acquisition or investment in complementary businesses or products or the right to use complementary technologies. The proceeds have been invested, pending their use as described, in short-term, interest bearing securities and debt instruments in compliance with our investment policy.

We have available a $5.0 million revolving credit facility with a bank, which expires June 30, 2004. Borrowings under the facility bear interest at LIBOR plus 2.25% and are payable on demand upon expiration of the facility. Borrowings also subject us to certain covenants, including, among other things, maintaining a minimum tangible net worth, a specified ratio of current assets to current liabilities and a covenant to remain profitable.

We had no material commitments for capital expenditures as of March 31, 2004 and have not entered into any material commitments after that date.

The following table presents our expected cash requirements for contractual obligations outstanding as of March 31, 2004 for the years ending December 31:

		Restated				
			Years Ending December 31,			
	March 31, 2004	Nine Months Ending December 31, 2004	2005	2006	2007	2008
Operating leases	$ 1,000,000	$ 389,000	$ 510,000	$ 92,000	$ 8,000	$ 1,000

We believe that our current cash balances plus cash expected to be generated from our operations will be adequate to meet our capital requirements and sustain our operations for at least the next twelve months. Our future capital requirements will depend on many factors, including the extent and timing of the deployment of the capital raised in our public offering and the rate at which our business continues to grow, with corresponding demands for working capital and manufacturing capacity. We could be required or may elect to seek additional funding through public or private equity or debt financing. However, additional funds may not be available on terms acceptable to us or at all.

New Accounting Pronouncements

In December 2003, the FASB issued FASB Interpretation No. 46R, Consolidation of Variable Interest Entities (FIN 46R). FIN 46R requires the application of either FIN 46 or FIN 46R by Public Entities to all Special Purpose Entities (SPE) created prior to February 1, 2003 as of December 31, 2003 for calendar year-end companies. FIN 46R is applicable to all non-SPEs created prior to February 1, 2003 at the end of the first interim or annual period ending after March 15, 2004. For all entities created subsequent to January 31, 2003, Public Entities were required to apply the provisions of FIN 46R. The adoption of FIN 46R did not have an impact to our consolidated financial position, results of operations or cash flows.

RISK FACTORS

Investing in our common stock involves a high degree of risk. You should carefully consider the following risks and all the other information in this report, in addition to other information contained in our other filings with the SEC, before making an investment decision about our common stock. While the risks described below are the ones we believe are most important for you to consider, these risks are not the only ones that we face. If any of the following risks actually occurs, our

Table of Contents

business, operating results or financial condition could suffer, the trading price of our common stock could decline and you could lose all or part of your investment.

Risks Relating to Our Business

Our quarterly sales and operating results may fluctuate in future periods and we may fail to meet expectations, which may cause the price of our common stock to decline.

Our quarterly sales and operating results have fluctuated and are likely to continue to vary from quarter to quarter due to a number of factors, many of which are not within our control. If our quarterly sales or operating results fall below the expectations of investors or securities analysts, the price of our common stock could decline substantially. Factors that might cause quarterly fluctuations in our sales and operating results include the following:

- variation in demand for our products, including variation due to seasonality
- our ability to research, develop, introduce, market and gain market acceptance of new products and product enhancements in a timely manner
- our ability to control costs
- the size, timing, rescheduling or cancellation of orders from distributors
- the introduction of new products by competitors
- long sales cycles and fluctuations in sales cycles
- the availability and reliability of components used to manufacture our products
- changes in our pricing policies or those of our suppliers and competitors, as well as increased price competition in general
- the mix of our domestic and international sales, and the risks and uncertainties associated with our international business
- costs associated with any future acquisitions of technologies and businesses
- limitations on our ability to use net operating loss carryforwards under the provisions of Internal Revenue Code Section 382 and similar provisions under applicable state laws

developments concerning the protection of our proprietary rights

general global economic and political conditions, including international conflicts and acts of terrorism

The amount of expenses we incur, in part, depends on our expectations regarding future sales. In particular, we expect to continue incurring substantial expenses relating to the marketing and promotion of our products. Since many of our costs are fixed in the short term, if we have a shortfall in sales, we may be unable to reduce expenses quickly enough to avoid losses. Accordingly, you should not rely on quarter-to-quarter comparisons of our operating results as an indication of our future performance. Additionally, as a result of the change in our revenue recognition policy in the third quarter of 2003, our quarterly sales and operating results for each of the next three quarters ending September 30, 2004, may not be directly comparable to corresponding periods in the preceding year due to the difference in the timing of revenue recognition.

Regulatory proceedings relating to the restatement of our consolidated financial statements could divert management s attention and resources.

We restated our previously issued financial statements in September 2003 to reflect a change in the timing of revenue recognition. We have received informal requests from the SEC to voluntarily provide information relating to the September 2003 restatement of our consolidated financial statements. We have provided information to the SEC and, if we receive any additional requests for information, we would cooperate in responding. In accordance with its normal practice, the SEC has not advised us if its inquiry has been concluded. If the SEC elects to request additional information from the company or commence further proceedings, responding to such requests or proceedings could divert management s attention and resources. Additionally, any negative developments arising from such requests or proceedings could harm our business and cause the price of our common stock to decline.

The loss of or a substantial reduction in, or change in the size or timing of, orders from distributors could harm our business.

Our international sales are principally comprised of sales through independent distributors, although we sell products in certain European countries through direct sales representatives. A significant amount of our sales may consist of sales through distributors. Net revenue to distributors accounted for approximately 13% of our total sales in 2003 and 17% of our total sales in 2002. No distributor

Table of Contents

accounted for more than 3% of our net sales in 2003 or 6% in 2002. The loss of a substantial number of our distributors or a substantial reduction in, cancellation of or change in the size or timing of orders from our current distributors could harm our business, financial condition and results of operations. The loss of a key distributor could affect our operating results due to the potential length of time that might be required to locate and qualify a new distributor or to retain direct sales representatives for the territory. There is no assurance that our distributors will perform as expected and we may experience lengthy delays and incur substantial costs if we are required to replace distributors in the future.

Variation in demand for our products due to seasonality can cause our operating results to fluctuate from quarter to quarter during the year.

We have experienced fluctuations in sales from quarter to quarter due to seasonality. In our experience, sales in the first quarter typically are lower than average and sales in the fourth quarter typically are stronger than average due to the buying patterns of dental professionals. For example, the fourth quarter of 2003 accounted for 33% of our net sales for the year, whereas the first quarter of 2003 accounted for 19% of net sales for the year. In addition, sales in the third quarter of the year may be affected by vacation patterns which can cause sales to be flat or lower than in the second quarter of the year. As a result, sequential quarter-to-quarter comparisons of our operating results may not be an indication of our performance for the year and may cause our results of operations and stock price to fluctuate.

Dentists and patients may be slow to adopt laser technologies, which could limit the market acceptance of our products.

Our dental laser systems represent relatively new technologies in the dental market. Currently, only a small percentage of dentists use lasers to perform dental procedures. Our future success will depend on our ability to increase demand for our products by demonstrating to a broad spectrum of dentists and patients the potential performance advantages of our laser systems over traditional methods of treatment and over competitive laser systems. Dentists have historically been and may continue to be slow to adopt new technologies on a widespread basis. This leads to long sales cycles and requires us to invest a significant amount of time and resources to educate customers about the benefits of our products and how they compare to competing products and technologies. Our sales personnel may be required to spend a substantial amount of time answering questions from potential customers and attending multiple in-person meetings over the course of several months before completing a sale. In addition, on occasion, our customers ask to return products after completing the purchase. Although we treat all sales as final, we may accept product returns from customers in certain circumstances. If requests for product returns become more pervasive, they could seriously harm our reputation and results of operations.

Factors that may inhibit adoption of laser technologies by dentists include cost, and concerns about the safety, efficacy and reliability of lasers. For example, the selling price of our Waterlase product is approximately $50,000, which is substantially above the cost of competing non-laser technologies. In order to make an investment in a Waterlase, a dentist generally would need to invest time to gain an understanding of the technology and how that technology will produce a return on investment. Similarly, although medical lasers are generally accepted in other specialties, a dentist generally would want to understand how the use of laser technology can improve the clinical outcomes and satisfaction of his or her own patients before making a substantial investment. Absent an immediate competitive motivation, a dentist may not feel compelled to invest the time required to learn about the potential benefits of using a laser. In addition, a dentistry practice, like any business, needs to make capital allocation decisions in which our product might compete with an unrelated alternative capital expenditure. Economic pressure, caused for example by an economic slowdown or by competitive factors in a specific market place, may make dentists reluctant to purchase substantial capital equipment or invest in new technologies. Patient acceptance will depend in part on the recommendations of dentists and specialists as well as other factors, including without limitation, the relative effectiveness, safety, reliability and comfort of our systems as compared with those of other instruments and methods for performing dental procedures. The failure of dental lasers to achieve broad market acceptance would have an adverse effect on our business, financial condition and results of operations. We cannot assure you that we will successfully achieve broad market acceptance for our products.

We may have difficulty managing our growth.

We have been experiencing significant growth in the scope of our operations and the number of our employees. This growth has placed significant demands on our management as well as our financial and operational resources. In order to achieve our business objectives, we anticipate that we will need to continue to grow. If this growth occurs, it will continue to place additional significant demands on our management and our financial and operational resources, and will require that we continue to develop and improve our operational, financial and other internal controls both in the United States and internationally. In particular, our growth has and, if it continues, will increase the challenges involved in implementing appropriate operational and financial systems, expanding manufacturing capacity and scaling up production, expanding our sales and marketing infrastructure and capabilities, providing adequate training and supervision to maintain high quality standards, and preserving our culture and values. The main challenge associated with our growth has been, and we believe will continue to be, our ability to recruit skilled sales, manufacturing and management personnel. Our inability to scale our business appropriately or otherwise adapt to growth would cause our business, financial condition and results of operations to suffer.

Table of Contents

If we are unable to protect our intellectual property rights, our competitive position could be harmed or we could be required to incur expenses to enforce our rights.

Our future success will depend, in part, on our ability to obtain and maintain patent protection for our products and technology, to preserve our trade secrets and to operate without infringing the intellectual property of others. In part, we rely on patents to establish and maintain proprietary rights in our technology and products. While we hold a number of issued patents and have other patent applications pending on our products and technology, we cannot assure you that any additional patents will be issued, that the scope of any patent protection will exclude competition or that any of our patents will be held valid if subsequently challenged. Other companies also may independently develop similar products, duplicate our products or design products that circumvent our patents. Additionally, the laws of foreign countries may not protect our products or intellectual property rights to the same extent as do the laws of the United States.

We face substantial uncertainty regarding the impact that other parties intellectual property positions will have on the markets for dental and other medical lasers. Competitors may claim that we have infringed their current or future intellectual property rights. The medical technology industry has in the past been characterized by a substantial amount of litigation and related administrative proceedings regarding patents and intellectual property rights. We may not prevail in any future intellectual property infringement litigation given the complex technical issues and inherent uncertainties in litigation. Any claims, with or without merit, could be time-consuming and distracting to management, result in costly litigation, cause product shipment delays, or require us to enter into royalty or licensing agreements. Additionally, if an intellectual property claim against us is successful, we might not be able to obtain a license on acceptable terms or license a substitute technology or redesign our products to avoid infringement. Any of the foregoing adverse events could seriously harm our business, financial condition and results of operations.

We are a party to a patent infringement lawsuit involving patents relating to our core technology, which if determined adversely to us, could have a significant negative effect on our earnings.

We are currently involved in a patent lawsuit with Diodem, LLC, a California limited liability company, which was founded by Collete Cozean, the former chief executive officer of Premier Laser Systems, Inc. The claims in this lawsuit were originally part of two separate lawsuits initiated in U.S. District Court. On May 2, 2003, we initiated a civil action in the U.S. District Court for the Central District of California against Diodem to obtain a judicial declaration against Diodem that technology used in our laser systems does not infringe four patents owned by Diodem. Diodem claims to have acquired the patents from Premier Laser Systems, Inc., which filed for bankruptcy protection in March 2000. On May 5, 2003, Diodem added us as a party to an infringement lawsuit it had previously filed in the U.S. District Court for the Central District of California. These lawsuits were consolidated into the currently pending lawsuit in August 2003. Diodem alleges that our technology, including the technology used in our Waterlase system, infringes four patents it acquired from Premier. Diodem seeks treble damages, a preliminary and permanent injunction from further alleged infringement, attorneys fees and other unspecified damages. This lawsuit is in the discovery phase of litigation, and may proceed for an extended period of time. There can be no assurance that our technology will not be found to infringe any of Diodem s patents at issue in this proceeding or that we will not be liable for some or all of the damages alleged by Diodem or subject to some or all of the relief requested by Diodem.

In addition, this lawsuit could result in significant expenses and diversion of management s time and other resources. If Diodem successfully asserts an infringement claim against us in the lawsuit, our operations may be severely impacted, especially to the extent that it affects our right to use the technology incorporated in our Waterlase system, which accounted for approximately 83% of our revenue in 2003 and approximately 77% of our revenue in 2002. This proceeding could also result in significant limitations on our ability to manufacture market and sell our products, including our Waterlase system, as well as delays and costs associated with redesigning our products and payments of license fees, monetary damages and other payments. Additionally, we may be enjoined from incorporating certain technology into our products, all of which could significantly impede our operations, increase operating expenses, reduce our revenue and cause us to incur losses.

We depend on a limited number of suppliers and if we cannot secure alternate suppliers, the amount of sales in any period could be adversely affected.

We purchase certain materials and components included in our Waterlase system and other products from a limited group of suppliers using purchase orders, and we have no written supply contracts with our key suppliers. Our business depends in part on our ability to obtain timely deliveries of materials and components in acceptable quality and quantities from our suppliers. The introduction of our LaserSmile system in 2001 was delayed due to an interruption in the supply of components for the system; however, we have not otherwise experienced material delays in the supply of components. Certain components of our products, particularly specialized components used in our lasers, are currently available only from a single source or limited sources. For example, the crystal, fiber and handpieces used in our Waterlase system are each supplied by a separate single supplier. We have not experienced material delays from these suppliers, and we have identified and tested alternative suppliers for each of these three components. However, an unexpected interruption in a single source supplier could create manufacturing delays, and disrupt sales and cash flow as we sought to replace the supplier, which we estimate could take up to three months. Such an interruption could cause our business, financial condition and results of operations to suffer.

Table of Contents

We have significant international sales and are subject to risks associated with operating in international markets.

International sales comprise a significant portion of our net sales and we intend to continue to pursue and expand our international business activities. International sales accounted for approximately 20% of our revenue in 2003 and approximately 23% of our revenue in 2002. Political and economic conditions outside the United States could make it difficult for us to increase our international sales or to operate abroad. International operations, including our facility in Germany, are subject to many inherent risks, including:

- adverse changes in tariffs
- political, social and economic instability and increased security concerns
- fluctuations in currency exchange rates
- longer collection periods and difficulties in collecting receivables from foreign entities
- exposure to different legal standards
- ineffectiveness of international distributors
- reduced protection for our intellectual property in some countries
- burdens of complying with a variety of foreign laws
- import and export license requirements and restrictions of the United States and each other country in which we operate
- trade restrictions
- the imposition of governmental controls
- unexpected changes in regulatory or certification requirements
- difficulties in staffing and managing international manufacturing and sales operations
- potentially adverse tax consequences and the complexities of foreign value added tax systems

We believe that international sales will continue to represent a significant portion of our net sales, and we intend to further expand our international operations. Our direct sales in Europe are denominated principally in euros, while our sales in other international markets are in dollars. As a result, an increase in the relative value of the dollar against the euro would lead to less income from sales denominated in euros, unless we increase prices, which may not be possible due to competitive conditions in Europe. We realized a gain of $232,000 on foreign currency transactions for the year ended December 31, 2003, due to a decrease in the value of the dollar relative to the value of the euro. We could experience losses from European transactions if the relative value of the dollar were to increase in the future. We do not currently engage in any transactions as a hedge against risks of loss due to foreign currency fluctuations, although we may consider doing so in the future. We also expect that sales of products manufactured at our facility in Germany will account for an increasing percentage of our revenue, which will further increase our exposure to the above-described risks associated with our international operations. Sales of products manufactured at our German facility accounted for 12% of our revenue in 2003 and approximately 9% of our revenue in 2002. Since expenses relating to our manufacturing operations in Germany are paid in euros, an increase in the value of the euro relative to the dollar would increase the expenses associated with our German manufacturing operations and reduce our earnings. In addition, we may experience difficulties associated with managing our operations remotely and complying with German regulatory and legal requirements for maintaining our manufacturing operations in that country. Any of these factors may adversely affect our future international sales and manufacturing operations and, consequently, negatively impact our business, financial condition and operating results. Despite these risks, we believe the market for our products outside the United States justifies our effort to expand our international operations.

If we are unable to meet customer demand or comply with quality regulations, our sales will suffer.

We manufacture our products at our California and German production facilities. In order to achieve our business objectives, we will need to significantly expand our manufacturing capabilities to produce the systems and accessories necessary to meet demand. We intend to finance the cost of expansion through the use of existing cash balances, operating income or funds available under our bank credit line. We may encounter difficulties in scaling-up production of our products, including problems involving production capacity and yields, quality control and assurance, component supply and shortages of qualified personnel. In addition, our manufacturing facilities are subject to periodic inspections by the U.S. Food and Drug Administration, state agencies and foreign regulatory agencies. Our success will depend in part upon our ability to manufacture our products in compliance with the U.S. Food and Drug Administration s Quality System regulations and other regulatory requirements. Our business will suffer if we do not

Table of Contents

succeed in manufacturing our products on a timely basis and with acceptable manufacturing costs while at the same time maintaining good quality control and complying with applicable regulatory requirements.

Any failure to significantly expand sales of our products will negatively impact our business.

We currently handle a majority of the marketing, distribution and sales of our laser systems. In order to achieve our business objectives, we will need to significantly expand our marketing and sales efforts on a nationwide and global basis. We will face significant challenges and risks in expanding, training, managing and retaining our sales and marketing teams, including managing geographically dispersed efforts. In addition, we use third party distributors to sell our products in a number of countries outside the United States, and are dependent on the sales and marketing efforts of these third party distributors. These distributors may not commit the necessary resources to effectively market and sell our products. If we are unable to expand our sales and marketing capabilities, we may not be able to effectively commercialize our products.

Acquisitions could have unintended negative consequences, which could harm our business.

As part of our business strategy, we may acquire one or more businesses, products or technologies. Acquisitions could require significant capital infusions and could involve many risks, including, but not limited to, the following:

- we may encounter difficulties in assimilating and integrating the operations, products and workforce of the acquired companies
- acquisitions may negatively impact our results of operations because they may require large one-time charges or could result in increased debt or contingent liabilities, adverse tax consequences, substantial depreciation or deferred compensation charges, or the amortization or write down of amounts related to deferred compensation, goodwill and other intangible assets
- acquisitions may be dilutive to our existing stockholders
- acquisitions may disrupt our ongoing business and distract our management
- key personnel of the acquired company may decide not to work for us

We cannot assure you that we will be able to identify or consummate any future acquisitions on acceptable terms, or at all. If we do pursue any acquisitions, it is possible that we may not realize the anticipated benefits from such acquisitions or that the market will not positively view such acquisitions.

Material increases in interest rates may harm our sales.

We currently sell our products primarily to dentists in general practice. These dentists often purchase our products with funds they secure through various financing arrangements with third party financial institutions, including credit facilities and short term loans. If interest rates increase, these financing arrangements will be more expensive to our dental customers, which would effectively increase the price of our products to our customers and, thereby, may decrease overall demand for our products. Any reduction in the sales of our products would cause our business to suffer.

We may not be able to compete successfully against our current and future competitors.

We compete with a number of foreign and domestic companies that market traditional dental products, such as dental drills, as well as other companies that market laser technologies in the dental and medical markets that we address, including companies such as Hoya ConBio, a subsidiary of Hoya Photonics, a large Japanese manufacturer primarily of optics and crystals, OpusDent Ltd., a subsidiary of Lumenis, Ka Vo, Deka Dental Corporation and Fotona d.d. Some of our competitors have greater financial, technical, marketing or other resources than us, which may allow them to respond more quickly to new or emerging technologies and to devote greater resources to the acquisition or development and introduction of enhanced products than we can. In addition, the rapid technological changes occurring in the healthcare industry are expected to lead to the entry of new competitors, especially as dental and medical lasers gain increasing market acceptance. Our ability to anticipate technological changes and to introduce enhanced products on a timely basis will be a significant factor in our ability to grow and remain competitive. New competitors or technological changes in laser products and methods could cause commoditization of such products, require price discounting or otherwise adversely affect our gross margins.

Rapid changes in technology could harm the demand for our products or result in significant additional costs.

The markets in which our laser systems compete are subject to rapid technological change, evolving industry standards, changes in the regulatory environment, frequent new device introductions and evolving dental and surgical techniques. These changes could render our products uncompetitive or obsolete. The success of our existing and future products is dependent on the differentiation of our products from those of our competitors, the timely introduction of new products and the perceived benefit to the customer in terms of improved patient satisfaction and return on investment. The process of developing new medical devices is inherently complex and

Table of Contents

requires regulatory approvals or clearances that can be expensive, time consuming and uncertain. We cannot assure you that we will successfully identify new product opportunities, be financially or otherwise capable of completing the research and development required to bring new products to market in a timely manner or that products and technologies developed by others will not render our products obsolete.

The failure to attract and retain key personnel could adversely affect our business.

Our future success depends in part on the continued service of certain key personnel, including our Chief Executive Officer, our Executive Vice President responsible for sales, our Chief Operating Officer, our Vice President of Research and Development and our Chief Financial Officer. We do not have employment agreements with any of our key employees, other than employment agreements with our Chief Executive Officer, and our Executive Vice President responsible for sales, each of which can be terminated at will by the executive or by us.

Our success will also depend in large part on our ability to continue to attract, retain and motivate qualified engineering and other highly skilled technical personnel. Competition for certain employees, particularly development engineers, is intense despite the effects of the economic slowdown. We may be unable to continue to attract and retain sufficient numbers of such highly skilled employees. Our inability to attract and retain additional key employees or the loss of one or more of our current key employees could adversely affect our business, financial condition and results of operations.

Product liability claims against us could be costly and could harm our reputation.

The sale of dental and medical devices involves the inherent risk of product liability claims against us. We currently maintain product liability insurance on a per occurrence basis with a limit of $11 million per occurrence and $12 million in the aggregate for all occurrences. The insurance is subject to various standard coverage exclusions, including damage to the product itself, losses from recall of our product and losses covered by other forms of insurance such as workers compensation. There is no assurance that we will be able to obtain such insurance in the future on terms acceptable to us, or at all. We do not know whether claims against us with respect to our products, if any, would be successfully defended or whether our insurance would be sufficient to cover liabilities resulting from such claims. Any claims successfully brought against us would cause our business to suffer.

Our ability to use net operating loss carryforwards may be limited.

Section 382 of the Internal Revenue Code of 1986 generally imposes an annual limitation on the amount of net operating loss carryforwards that may be used to offset taxable income when a corporation has undergone significant changes in its stock ownership. We have completed an analysis to determine the applicability of the annual limitations imposed by Section 382 caused by previous changes in our stock ownership and have determined that such limitations should not be significant. Based on our analysis, we believe that, as of December 31, 2003, approximately $32.4 million of net operating loss carryforwards was available to us for federal income tax purposes. Of this amount, approximately $27.7 million is available to offset 2004 federal taxable income or the taxable income generated in future years. Additional net operating loss carryforwards will become available at the rate of approximately $1.0 million per year for the years 2005 through 2009. However, any future ownership changes qualifying under Section 382 may similarly affect our ability to use our remaining net operating loss carryforwards. If we lose our ability to use net operating loss carryforwards, our income will be subject to tax earlier than it would be if we were able to use net operating loss carryforwards, resulting in lower profits.

We are exposed to risks associated with the recent worldwide economic slowdown and related uncertainties.

Concerns about decreased consumer and investor confidence, reduced corporate profits and capital spending, and recent international conflicts and terrorist and military activity have resulted in a downturn in the equity markets and a slowdown in economic conditions, both domestically and internationally, and have caused concern about the strength or longevity of an economic recovery. These unfavorable conditions could ultimately cause a slowdown in customer orders or cause customer order cancellations. In addition, recent political and social turmoil related to international conflicts and terrorist acts may put further pressure on economic conditions in the United States and abroad. Unstable political, social and economic conditions make it difficult for our customers, our suppliers and us to accurately forecast and plan future business activities. If such conditions continue or worsen, our business, financial condition and results of operations could suffer.

We may not be able to secure additional financing to meet our future capital needs.

We expect to expend significant capital to further develop our products, increase awareness of our laser systems and our brand names and to expand our operating and management infrastructure as we increase sales in the United States and abroad. We may use capital more rapidly than currently anticipated. Additionally, we may incur higher operating expenses and generate lower revenue than currently expected, and we may be required to depend on external financing to satisfy our operating and capital needs, including the repayment of future debt obligations. We may be unable to secure additional debt or equity financing on terms acceptable to us, or at all, at the time when we need such funding. If we do raise funds by issuing additional equity or convertible debt securities, the ownership percentages of existing stockholders would be reduced, and the securities that we issue may have rights, preferences or privileges senior to those of the holders of our common stock or may be issued at a discount to the market price of our common stock which would result in dilution to our existing stockholders. If we raise additional funds by issuing debt, we may be subject to debt

Table of Contents

covenants, such as the debt covenants under our secured credit facility, which could place limitations on our operations including our ability to declare and pay dividends. Our inability to raise additional funds on a timely basis would make it difficult for us to achieve our business objectives and would have a negative impact on our business, financial condition and results of operations.

We have adopted anti-takeover defenses that could delay or prevent an acquisition of our company and may affect the price of our common stock.

Certain provisions of our certificate of incorporation and stockholder rights plan could make it difficult for any party to acquire us, even though an acquisition might be beneficial to our stockholders. These provisions could limit the price that investors might be willing to pay in the future for shares of our common stock.

In December 1998, we adopted a stockholder rights plan pursuant to which one preferred stock purchase right is distributed to our stockholders for each share of our common stock held by them. In connection with the stockholder rights plan, the Board of Directors may issue up to 500,000 shares of Series B Junior Participating Cumulative Preferred Stock (which may be increased by up to 500,000 more shares out of undesignated preferred stock described in the paragraph below that is available under our certificate of incorporation). If any party acquires 15% or more of our outstanding common stock or commences a tender offer to acquire 15% or more of our outstanding stock, the holders of these rights will be able to purchase the underlying junior participating preferred stock as a way to discourage, delay or prevent a change in control of our company. Following the acquisition of 15% or more of our stock by any person, if we are acquired by or merged with any other entity, holders of these rights will be able to purchase shares of common stock of the acquiring or surviving entity as a further means to discourage, delay or prevent a change in control of our company.

In addition, under our certificate of incorporation, the Board of Directors has the power to authorize the issuance of up to 500,000 shares of preferred stock that is currently undesignated, and to designate the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without further vote or action by the stockholders. Accordingly, our Board of Directors may issue preferred stock with terms that could have preference over and adversely affect the rights of holders of our common stock.

The issuance of any preferred stock may:

- delay, defer or prevent a change in control of BIOLASE
- discourage bids for the common stock at a premium over the market price of our common stock
- adversely affect the voting and other rights of the holders of our common stock
- discourage acquisition proposals or tender offers for our shares

Risks Relating to Our Industry

Changes in government regulation or the inability to obtain or maintain necessary government approvals could harm our business.

Our products are subject to extensive government regulation, both in the United States and in other countries. To clinically test, manufacture and market products for human use, we must comply with regulations and safety standards set by the U.S. Food and Drug Administration and comparable state and foreign agencies. Regulations adopted by the U.S. Food and Drug Administration are wide ranging and govern, among other things, product design, development, manufacture and testing, labeling, storage, advertising and sales. Generally, products must meet regulatory standards as safe and effective for their intended use before being marketed for human applications. The clearance process is expensive, time-consuming and uncertain. Failure to comply with applicable regulatory requirements of the U.S. Food and Drug Administration can result in an enforcement action which may include a variety of sanctions, including fines, injunctions, civil penalties, recall or seizure of our products, operating restrictions, partial suspension or total shutdown of production and criminal prosecution. The failure to receive or maintain requisite approvals for the use of our products or processes, or significant delays in obtaining such approvals, could prevent us from developing, manufacturing and marketing products and services necessary for us to remain competitive. In addition, unanticipated changes in existing regulatory requirements or the adoption of new requirements could impose significant costs and burdens on us, which could increase our operating expenses, reduce our revenue and profits, and result in operating losses.

If our customers cannot obtain third party reimbursement for their use of our products, they may be less inclined to purchase our products.

Our products are generally purchased by dental or medical professionals who have various billing practices and patient mixes. Such practices range from primarily private pay to those who rely heavily on third party payors, such as private insurance or government programs. In the United States, third party payors review and frequently challenge the prices charged for medical services. In many foreign countries, the prices for dental services are predetermined through government regulation. Payors may deny coverage and reimbursement if they determine that the procedure was not medically necessary, such as a cosmetic procedure, or that

Table of Contents

the device used in the procedure was investigational. We believe that most of the procedures being performed with our current products generally are reimbursable, with the exception of cosmetic applications such as tooth whitening. For the portion of dentists who rely heavily on third party reimbursement, the inability to obtain reimbursement for services using our products could deter them from purchasing or using our products. We cannot predict the effect of future healthcare reforms or changes in financing for health and dental plans. Any such changes could have an adverse effect on the ability of a dental or medical professional to generate a return on investment using our current or future products. Such changes could act as disincentives for capital investments by dental and medical professionals and could have a negative impact on our business, financial condition and results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We do not engage in transactions to offset currency fluctuations, and we are at risk for changes in the value of the dollar relative to the euro. Our sales in Europe are denominated principally in euros, and our sales in other international markets are denominated in dollars. As a result, an increase in the relative value of the dollar to the euro would lead to less income from sales denominated in euros, unless we increase prices, which may not be possible due to competitive conditions in Europe. Additionally, since expenses relating to our manufacturing operations in Germany are paid in euros, an increase in the value of the Euro relative to the dollar would increase the expenses associated with our German manufacturing operations and reduce our earnings.

ITEM 4. CONTROLS AND PROCEDURES.

(a) As more fully described in the Explanatory Note of this Form 10-Q/A and in Note 3 to the Consolidated Financial Statements of our Annual Report on Form 10-K for the fiscal year ended December 31, 2004, we have restated our financial statements for the full 2002 fiscal year, the first, second, third and fourth fiscal quarters of 2003, the full 2003 fiscal year, and the first, second and third fiscal quarters of 2004.

As described more fully in our Management s Report on Internal Control over Financial Reporting set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2004, management assessed the effectiveness of our internal control over financial reporting as of December 31, 2004, and this assessment identified internal control deficiencies that individually or collectively constitute material weaknesses in our internal control over financial reporting. Management currently is implementing certain remedial measures identified in Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2004, and intends to implement the remaining remedial measures during the course of 2005. While this implementation is underway, we are relying on extensive manual procedures and the utilization of outside accounting professionals. While we are implementing changes to our controls environment, there remains a risk that the transitional procedures on which we are currently relying will fail to be sufficiently effective to address the internal control deficiencies identified in Management s Report on Internal Control over Financial Reporting. Please see Part I, Item 2. Management s Discussion and Analysis Risk Factors Our internal controls and procedures need to be improved contained in our Annual Report on Form 10-K for the year ended December 31, 2004.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934 (the Exchange Act). In light of the material weaknesses referenced below and in Management s Report on Internal Control over Financial Reporting included in Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2004, which were also in existence as of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were not effective. However, our Chief Executive Officer and our Chief Financial Officer believe that the remedial measures described in Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2004, when implemented, will be effective to address the material weaknesses described in Management s Report on Internal Control over Financial Reporting and should allow us to conclude that our disclosure controls and procedures are effective at a reasonable level of assurance at future filing dates.

There were material weaknesses in our internal control over financial reporting as of the end of the period covered by this Form 10-Q/A, which have subsequently been remediated and are operating effectively as of December 31, 2004. During the quarter ended March 31, 2004, we did not have effective controls over the completeness and accuracy of accrued payroll and sales tax and the related expense accounts. This resulted in adjustments to the consolidated financial statements for the quarter ended March 31, 2004 as described in Note 3 to the unaudited consolidated financial statements included in this Form 10-Q/A. Additionally, these control deficiencies could result in a material misstatement to accrued payroll and sales tax and the related expense accounts that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined these control deficiencies constitute material weaknesses.

(b) Changes in internal control over financial reporting. There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) identified in connection with the evaluation described in Item 4(a) above that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

We are currently involved in two related patent lawsuits with Diodem, LLC, a California limited liability company. On May 2, 2003, we initiated a civil action in the U.S. District Court for the Central District of California against Diodem. In this lawsuit we are seeking a judicial declaration against Diodem that technology we use in our laser systems does not infringe four patents owned by Diodem. Diodem was founded by Collete Cozean, the former chief executive officer of Premier Laser Systems, Inc., a medical laser company which filed for bankruptcy protection in March 2000. Diodem claims to have acquired the four patents at issue in the case from Premier Laser. In 2000 we initiated a patent infringement lawsuit against Premier Laser seeking damages and to prevent Premier from selling competing dental lasers on the grounds that they infringed on certain of our patents. The lawsuit was stayed by the bankruptcy court after Premier filed for bankruptcy.

In response to our lawsuit against Diodem, on May 5, 2003, Diodem added us as a party to an infringement lawsuit it had previously filed in the U.S. District Court for the Central District of California. The other parties to this lawsuit are American Medical Technologies, Inc. (AMT), Lumenis and its subsidiary OpusDent, Ltd., and Hoya Photonics and its subsidiary Hoya ConBio. OpusDent and Hoya ConBio manufacture and sell dental lasers pursuant to patents originally licensed to them by AMT. We acquired the licensed patents and related license agreements in our acquisition of the American Dental Laser product line from AMT. Diodem s lawsuit against us alleges that our Waterlase product infringes upon the four patents that Diodem acquired from Premier Laser. Diodem also alleges that the products sold by OpusDent and Hoya ConBio also infringe upon the patents. Diodem s infringement suit

Table of Contents

seeks treble damages, a preliminary and permanent injunction from further alleged infringement, attorneys fees and other unspecified damages. If Diodem successfully asserts an infringement claim against us, our operations may be significantly impacted, especially to the extent that it affects our right to use the technology incorporated in our Waterlase system, which accounted for approximately 77% of our revenue in the first quarter of 2004 and approximately 83% of our revenue of the year ended December 31, 2003. If Diodem successfully asserts an infringement claim against Hoya ConBio and OpusDent, it could reduce or eliminate royalties we might receive under licenses to those products, which have totaled approximately $372,000 since the acquisition of the American Dental Laser assets in May 2003. Both of these lawsuits are in their preliminary stages, and may proceed for an extended period of time. Although the outcome of these actions cannot be determined with any certainty, we believe our technology and products do not infringe any valid patent rights owned by Diodem, and we intend to continue to vigorously defend against Diodem s infringement action and pursue our declaratory relief action against Diodem. No amounts have been recorded in the consolidated financial statements relating to the outcome of this matter.

Although the outcome of these actions cannot be determined with certainty, we believe our technology and products do not infringe any valid patent rights owned by Diodem, and we intend to continue to vigorously defend against Diodem s infringement action and pursue our declaratory relief action against Diodem.

We are not currently subject to any other material pending or threatened legal proceedings.

ITEM 6. EXHIBITS

Exhibits	Description
31.1	Certification of Robert E. Grant Pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.
31.2	Certification of John W. Hohener Pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.
32.1	Certification of Robert E. Grant Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of John W. Hohener Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

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

Dated: July 19, 2005

BIOLASE TECHNOLOGY, INC.,
a Delaware corporation

By: /s/ JOHN W. HOHENER
John W. Hohener

Executive Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)