

BIOLASE, INC
Form 10-Q
August 01, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

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 001-36385

BIOLASE, INC.

(Exact name of registrant as specified in its charter)

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

4 Cromwell

Irvine, California 92618

(Address of principal executive offices, including zip code)

(949) 361-1200

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

The number of shares of the issuer's common stock, \$0.001 par value per share, outstanding, as of July 29, 2016, was 58,257,301 shares.

BIOLASE, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BIOLASE, INC.

CONSOLIDATED BALANCE SHEETS (Unaudited)

(in thousands, except per share data)

	June 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$4,877	\$11,699
Restricted cash equivalent	200	200
Accounts receivable, less allowance of \$1,616 in 2016 and \$1,765 in 2015	11,036	8,948
Inventory, net	11,262	12,566
Prepaid expenses and other current assets	1,132	1,387
Total current assets	28,507	34,800
Property, plant, and equipment, net	3,994	3,727
Intangible assets, net	23	51
Goodwill	2,926	2,926
Other assets	551	747
Total assets	\$36,001	\$42,251
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$6,914	\$5,960
Accrued liabilities	4,810	5,906
Customer deposits	66	85
Deferred revenue, current portion	3,161	3,155
Total current liabilities	14,951	15,106
Deferred income taxes, net	768	738
Deferred revenue, long-term	82	142
Capital lease obligation, long-term	74	159
Warranty accrual, long-term	866	843
Other liabilities, long-term	308	338
Total liabilities	17,049	17,326
Commitments, contingencies, and subsequent events (Notes 8 and 12)		
Stockholders' equity:		
Preferred stock, par value \$0.001 per share; 1,000 shares authorized, no shares issued and outstanding	—	—
Common stock, par value \$0.001 per share; 100,000 shares	58	58

authorized as of June 30, 2016 and 2015;

58,257 and 58,228 shares issued and outstanding as of

June 30, 2016 and 2015, respectively

Additional paid-in-capital	190,402	188,622
Accumulated other comprehensive loss	(756)	(801)
Accumulated deficit	(170,752)	(162,954)
Total stockholders' equity	18,952	24,925
Total liabilities and stockholders' equity	\$36,001	\$42,251

See accompanying notes to unaudited consolidated financial statements.

BIOLASE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS (Unaudited)

(in thousands, except per share data)

	Three Months		Six Months Ended	
	Ended June 30, 2016	2015	June 30, 2016	2015
Products and services revenue	\$13,755	\$11,835	\$24,734	\$22,586
License fees and royalty revenue	55	34	86	138
Net revenue	13,810	11,869	24,820	22,724
Cost of revenue	8,154	8,168	15,520	15,813
Gross profit	5,656	3,701	9,300	6,911
Operating expenses:				
Sales and marketing	4,488	4,743	8,292	9,497
General and administrative	2,655	3,916	4,922	6,503
Engineering and development	1,900	1,974	3,786	3,777
Excise tax	—	97	—	153
Legal settlement	—	—	—	(731)
Total operating expenses	9,043	10,730	17,000	19,199
Loss from operations	(3,387)	(7,029)	(7,700)	(12,288)
Gain (loss) on foreign currency transactions	(126)	1	(55)	(129)
Interest income, net	17	23	34	23
Non-operating income (loss), net	(109)	24	(21)	(106)
Loss before income tax provision	(3,496)	(7,005)	(7,721)	(12,394)
Income tax provision	37	36	77	83
Net loss	(3,533)	(7,041)	(7,798)	(12,477)
Other comprehensive income (loss) items:				
Foreign currency translation adjustment	(54)	33	45	(200)
Comprehensive loss	\$(3,587)	\$(7,008)	\$(7,753)	\$(12,677)
Net loss per share:				
Basic	\$(0.06)	\$(0.12)	\$(0.13)	\$(0.21)
Diluted	\$(0.06)	\$(0.12)	\$(0.13)	\$(0.21)
Shares used in the calculation of net loss per share:				
Basic	58,257	58,180	58,243	58,163
Diluted	58,257	58,180	58,243	58,163

See accompanying notes to unaudited consolidated financial statements.

BIOLASE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(in thousands)

	Six Months Ended June 30,	
	2016	2015
Cash Flows from Operating Activities:		
Net loss	\$(7,798)	\$(12,477)
Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	488	324
(Recovery) provision for bad debts, net	(85)	281
Stock-based compensation	1,780	1,635
Deferred income taxes	30	31
Earned interest income, net	(33)	(23)
Changes in operating assets and liabilities:		
Restricted cash	—	(200)
Accounts receivable	(1,968)	(1,031)
Inventory	908	(1,172)
Prepaid expenses and other current assets	451	(385)
Customer deposits	(19)	(16)
Accounts payable and accrued liabilities	25	1,237
Deferred revenue	(54)	757
Net cash and cash equivalents used in operating activities	(6,275)	(11,039)
Cash Flows from Investing Activities:		
Purchases of property, plant, and equipment	(502)	(433)
Net cash and cash equivalents used in investing activities	(502)	(433)
Cash Flows from Financing Activities:		
Principal payments under capital lease obligation	(86)	—
Deposit on capital lease	—	(42)
Proceeds from exercise of stock options and warrants	—	44
Net cash and cash equivalents (used in) provided by financing activities	(86)	2
Effect of exchange rate changes	41	(168)
Decrease in cash and cash equivalents	(6,822)	(11,638)
Cash and cash equivalents, beginning of period	11,699	31,560
Cash and cash equivalents, end of period	\$4,877	\$19,922
Supplemental cash flow disclosure - Cash Paid:		
Interest paid	\$2	\$—
Income taxes paid	\$48	\$44
Supplemental cash flow disclosure - Non-cash:		
Assets acquired under capital lease	\$—	\$405
Accrued capital expenditures and tenant improvement allowance	\$102	\$555

See accompanying notes to unaudited consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1—DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

The Company

BIOLASE, Inc. (“BIOLASE” and, together with its consolidated subsidiaries, the “Company”) is a medical device company that develops, manufactures, markets, and sells laser systems in dentistry and medicine and also markets, sells, and distributes dental imaging equipment, including cone beam digital x-rays and CAD/CAM intra-oral scanners, in-office, chair-side milling machines and three-dimensional (“3-D”) printers.

Basis of Presentation

The unaudited consolidated financial statements include the accounts of BIOLASE and its wholly-owned subsidiaries and have been prepared on a basis consistent with the December 31, 2015 audited consolidated financial statements and include all material adjustments, consisting of normal recurring adjustments and the elimination of all material intercompany transactions and balances, necessary to fairly present the information set forth therein. These unaudited, interim, consolidated financial statements do not include all the footnotes, presentations, and disclosures normally required by accounting principles generally accepted in the United States of America (“GAAP”) for complete consolidated financial statements. Certain amounts have been reclassified to conform to current period presentations.

The consolidated results of operations for the three and six months ended June 30, 2016 are not necessarily indicative of the results for the full year. The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2015, included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission (the “SEC”) on March 11, 2016 (the “2015 Form 10-K”).

Liquidity and Management’s Plans

The Company incurred a loss from operations, a net loss, and used cash in operating activities for the three and six months ended June 30, 2016. The Company has also suffered recurring losses from operations during the three years ended December 31, 2015. The Company’s recurring losses, level of cash used in operations, the potential need for additional capital, and the uncertainties surrounding the Company’s ability to raise additional capital, raises substantial doubt about the Company’s ability to continue as a going concern. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

As of June 30, 2016, the Company had working capital of approximately \$13.6 million. The Company’s principal sources of liquidity as of June 30, 2016 consisted of approximately \$5.1 million in cash, cash equivalents and restricted cash and \$11.0 million of net accounts receivable.

In order for the Company to continue operations beyond the next 12 months and be able to discharge its liabilities and commitments in the normal course of business, the Company must increase sales of its products directly to end-users and through distributors, establish profitable operations through the combination of increased sales and decreased expenses, generate cash from operations or obtain additional funds when needed. The Company intends to improve its financial condition and ultimately improve its financial results by increasing revenues through expansion of its product offerings, continuing to expand and develop its field sales force and distributor relationships both domestically and internationally, forming strategic arrangements within the dental and medical industries, educating dental and medical patients as to the benefits of its advanced medical technologies, and reducing expenses.

Additional capital requirements may depend on many factors, including, among other things, continued losses, the rate at which the Company's business grows, demands for working capital, manufacturing capacity, and any acquisitions that the Company may pursue. From time to time, the Company could be required, or may otherwise attempt, to raise capital, through either equity or debt offerings, or enter into a line of credit facility. The Company cannot provide assurances that it will be able to successfully enter into any such equity or debt financings or line of credit facility in the future or that the required capital would be available on acceptable terms, if at all, or that any such financing activity would not be dilutive to its stockholders.

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("U. S. GAAP") requires the Company to make estimates and assumptions that affect amounts reported in the consolidated financial statements and the accompanying notes. Significant estimates in these consolidated financial statements include allowances on accounts receivable, inventory, and deferred taxes, as well as estimates for accrued warranty expenses, goodwill and the ability of goodwill to be realized, revenue deferrals, effects of stock-based compensation and warrants, contingent liabilities, and the provision or benefit for income taxes. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may differ materially from those estimates.

Critical Accounting Policies

Information with respect to the Company's critical accounting policies, which management believes could have the most significant effect on the Company's reported results and require subjective or complex judgments by management is contained in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of the 2015 Form 10-K. Management believes that there have been no significant changes during the three and six months ended June 30, 2016 in the Company's critical accounting policies from those disclosed in Item 7 of the 2015 Form 10-K.

Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal market (or, if none exists, the most advantageous market) for the specific asset or liability at the measurement date (referred to as the "exit price"). The fair value is based on assumptions that market participants would use, including a consideration of nonperformance risk. Under the accounting guidance for fair value hierarchy there are three levels of measurement inputs. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs reflect input other than quoted prices included in Level 1 that are observable, either directly or through collaboration with observable market data, other than Level 1. Level 3 inputs are unobservable due to little or no corroborating market data.

The Company's financial instruments, consisting of cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, approximate fair value because of the short maturity of these items.

Recent Accounting Pronouncements

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

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

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Recently Issued Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”), which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five-step process to achieve this core principle, and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP.

The standard is effective for annual periods beginning after December 15, 2017, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). The Company is currently evaluating the impact of the pending adoption of ASU 2014-09 on its consolidated financial statements and has not yet determined the method by which it will adopt the standard during the year ending December 31, 2018.

In August 2014, the FASB issued ASU No. 2014-15, Disclosure of Uncertainties About an Entity’s Ability to Continue as a Going Concern. The standard requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give rise to substantial doubt about an entity’s ability to continue as a going concern. ASU 2014-15 applies to all entities and is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. The Company will follow this guidance beginning in fiscal 2017.

In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory (“ASU 2015-11”), as part of its simplification initiative. The standard requires inventory within the scope of ASU 2015-11 to be measured using the lower of cost and net realizable value. The changes apply to all types of inventory, except those measured using the last-in-first-out method or the retail inventory method. ASU 2015-11 applies to all entities and is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2016, with early adoption permitted. The Company does not expect that the adoption of this standard will have a material effect on its financial statements.

In November 2015, FASB issued ASU 2015-17, Income Taxes (Topic 740). Current GAAP requires an entity to separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position. To simplify the presentation of deferred income taxes, the amendments in this ASU require that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments in this ASU apply to all entities that present a classified statement of financial position. The new standard is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years with early adoption permitted. The Company will follow the guidance for fiscal year 2017.

In February 2016, FASB issued ASU 2015-17, Leases. The new standard establishes a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative

period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the impact of its pending adoption of the new standard on its consolidated financial statements.

NOTE 3—STOCK-BASED AWARDS AND PER SHARE INFORMATION

Stock-Based Compensation

The Company currently has one stock-based compensation plan, the 2002 Stock Incentive Plan (as amended effective as of May 26, 2004, November 15, 2005, May 16, 2007, May 5, 2011, June 6, 2013, October 30, 2014, April 27, 2015, and May 6, 2016) (the “2002 Plan”), which will expire on May 5, 2019. Persons eligible to receive awards under the 2002 Plan include officers, employees, and directors of the Company, as well as consultants. As of June 30, 2016, a total of 15,550,000 shares have been authorized for issuance under the 2002 Plan, of which 3,098,000 shares of BIOLASE common stock have been issued pursuant to options that were exercised and restricted stock units (“RSUs”) that were settled in common stock, 6,201,000 shares of BIOLASE common stock have been reserved for outstanding options and unvested RSUs, and 6,251,000 shares of BIOLASE common stock remain available for future grants.

The Company recognized stock-based compensation cost of \$946,000 and \$935,000, for the three months ended June 30, 2016 and 2015 respectively, and \$1.8 million and \$1.6 million, for the six months ended June 30, 2016 and 2015 respectively, based on the grant-date fair value. The net impact to earnings was \$(0.02), and \$(0.02) per basic and diluted share for the three months ended June 30, 2016 and 2015, respectively, and \$(0.03) and \$(0.03) per basic and diluted share for the six months ended June 30, 2016 and 2015, respectively. At June 30, 2016, the Company had approximately \$4.5 million of total unrecognized compensation cost, net of estimated forfeitures, related to unvested share-based compensation arrangements. The Company expects that cost to be recognized over a weighted-average period of 2.5 years.

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

	Three Months Ended June 30, 2016		Six Months Ended June 30, 2015	
Cost of revenue	\$99	\$62	\$169	\$138
Sales and marketing	187	194	321	487
General and administrative	541	612	1,092	848
Engineering and development	119	67	198	162
	\$946	\$935	\$1,780	\$1,635

The stock option fair values, under the 2002 Plan, were estimated using the Black-Scholes option-pricing model with the following assumptions:

	Three Months Ended June 30, 2016		Six Months Ended June 30, 2015	
Expected term	5.6 years	5.5 years	5.7 years	5.9 years
Volatility	83.8%	87.7%	84.8%	91.0%
Annual dividend per share	\$ —	\$ —	\$ —	\$ —
Risk-free interest rate	1.32%	1.54%	1.34%	1.65%

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A summary of option activity under the 2002 Plan for the six months ended June 30, 2016 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value(1)
Options outstanding, December 31, 2015	4,493,000	\$ 2.72	6.59	\$422
Granted at fair market value	1,253,000	\$ 1.29		
Exercised	—	\$ —		
Forfeited, cancelled, or expired	(422,000)	\$ 3.26		
Options outstanding at June 30, 2016	5,324,000	\$ 2.34	7.29	\$ 115,000
Options exercisable at June 30, 2016	3,098,000	\$ 2.76	6.05	\$ 28,000
Vested options expired during the quarter ended June 30, 2016	87,000	\$ 2.76		

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

Cash proceeds, along with fair value disclosures related to grants, exercises, and vested options under the 2002 Plan are as follows for the three and six months ended June 30 (in thousands, except per share amounts):

	Three Months Ended June 30, 2016		Six Months Ended June 30, 2015	
Proceeds from stock options exercised	\$—	\$—	\$—	\$44
Tax benefit related to stock options exercised (1)	N/A	N/A	N/A	N/A
Intrinsic value of stock options exercised (2)	\$—	\$—	\$—	\$52
Weighted-average fair value of options granted during period	\$0.97	\$1.42	\$0.90	\$1.70
Total fair value of shares vested during the period	\$341	\$440	\$1,053	\$733

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

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

On February 26, 2016 in connection with the Company's new 2016 compensation plan, the Compensation Committee of the Board of Directors (the "Board"), awarded to certain employees and consultants of the Company a total of 295,000 non-qualified stock options to purchase shares of BIOLASE common stock. These awards were issued at \$0.86 per share, the closing market price of the BIOLASE common stock on the grant date, and expire 10 years from the grant date. Vesting periods for options are as follows: (i) 185,000 options, awarded to existing employees, vest ratably over a 48 month period, commencing one month from the grant date, and (ii) 110,000 options, awarded to new 2016 employees, vest 25% on the one-year anniversary of the grant date and the remainder ratably over the 36-month period, commencing 13 months after of the grant date.

On April 18, 2016, in connection with the hiring of the two new Vice Presidents, the Compensation Committee of the Board awarded 325,000 non-qualified stock options to purchase shares of BIOLASE common stock. These awards were issued at \$1.43 per share, the closing market price of BIOLASE common stock on the grant date, and expire 10 years from the grant date. Vesting periods for the options are as follows: (i) one-half of the total grant is subject to time vesting with 25% vesting as of April 18, 2017 and the remaining 75% vesting ratably monthly over a thirty-six month period commencing on April 18, 2017, and (ii) one-half of the total grant is subject to specific 2016 and 2017 performance criteria.

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On May 6, 2016, non-employee directors of the Company were granted a total of 597,757 non-qualified stock options to purchase shares of BIOLASE common stock. These awards were issued at \$1.41 per share, the closing market price of BIOLASE common stock on the grant date, and expire 10 years from the grant date. The total grant vests in equal installments over a consecutive twelve month period, commencing on June 6, 2016.

Restricted Stock Units

In accordance with the 2002 Plan, the Company approved restricted stock units (“RSUs”) to acquire shares of BIOLASE common stock as approved by the Board. Effective February 26, 2016, the Compensation Committee of the Board issued the following awards:

Under the 2015 compensation plan, 388,500 RSUs were awarded to certain employees and consultants of the Company. These awards were valued at \$0.86 per share, the closing market price of BIOLASE common stock on the grant date, and will fully vest on July 1, 2016.

Under the new 2016 compensation plan, 140,000 RSUs were awarded to certain employees and consultants of the Company. These awards were valued at \$0.86 per share, the closing market price of BIOLASE common stock on the grant date, and vest 25% on each of the first, second, third, and fourth anniversaries of the grant date.

In connection with the President and Chief Executive Officer’s employment agreement, the maximum performance bonus was awarded, consisting of (i) \$100,000 paid in cash during the six months ended June 30, 2016, and (ii) 59,523 RSUs, valued at \$0.86 per share, the closing market price of BIOLASE common stock on the grant date. Half of these RSUs vested on March 30, 2016 and half of these RSUs will vest on February 18, 2017.

On March 10, 2016, under the 2015 compensation plan, the Compensation Committee of the Board approved the grant of 70,000 RSUs to the Company’s Chief Financial Officer. These awards were valued at \$1.23 per share, the closing market price of BIOLASE common stock on the grant date, and fully vested on July 1, 2016.

On May 6, 2016, non-employee directors of the Company were granted a total 248,750 RSUs valued at \$1.41 per share, the closing market price of BIOLASE common stock on the grant date. Total grant vests on May 6, 2017.

A summary of RSU activity under the 2002 Plan for the six months ended June 30, 2016 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Nonvested restricted stock units at December 31, 2015	—	
Granted	906,773	\$ 1.04
Vested	(29,762)	\$ 0.86
Forfeited or cancelled	—	
Nonvested restricted stock units at June 30, 2016	877,011	\$ 1.05

Warrants

The Company issues warrants to acquire shares of BIOLASE common stock as approved by the Board. A summary of warrant activity for the six months ended June 30, 2016 is as follows:

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	Shares	Weighted Average Exercise Price
Warrants outstanding, December 31, 2015	10,094,000	\$ 4.18
Granted	—	
Exercised	—	
Forfeited, cancelled, or expired	(723,000)	\$ 6.50
Warrants outstanding at June 30, 2016	9,371,000	\$ 4.00
Warrants exercisable at June 30, 2016	9,236,000	\$ 4.00
Vested warrants expired during the quarter ended June 30, 2016	(723,000)	\$ 6.50

Net Loss Per Share – Basic and Diluted

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

Outstanding stock options and warrants to purchase approximately 15,572,000 shares were not included in the calculation of diluted loss per share for the three and six months ended June 30, 2016 as their effect would have been anti-dilutive. For the same 2015 period, anti-dilutive outstanding stock options and warrants to purchase 16,251,000 shares were not included in the computation of diluted loss per share.

NOTE 4—INVENTORY

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

	June 30, 2016	December 31, 2015
Raw materials	\$3,394	\$ 3,627
Work-in-process	1,567	1,379
Finished goods	6,301	7,560
Inventory, net	\$11,262	\$ 12,566

Inventory is net of a provision for excess and obsolete inventory totaling \$2.1 million and \$2.1 million as of June 30, 2016 and December 31, 2015, respectively.

NOTE 5—PROPERTY, PLANT, AND EQUIPMENT

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

	June 30, 2016	December 31, 2015
Building	\$206	\$ 203
Leasehold improvements	2,004	2,019
Equipment and computers	6,545	6,031
Furniture and fixtures	599	585
Construction in progress	1,255	1,045
	10,609	9,883
Accumulated depreciation and amortization	(6,776)	(6,314)
	3,833	3,569
Land	161	158
Property, plant, and equipment, net	\$3,994	\$ 3,727

Depreciation and amortization expense related to property, plant, and equipment totaled \$262,000 and \$460,000 for the three and six months ended June 30, 2016, respectively, and \$149,000 and \$289,000 for the three and six months ended June 30, 2015, respectively.

The cost basis of assets held under capital lease was \$378,000 and the accumulated depreciation related to assets held under capital lease was \$151,000 as of June 30, 2016. For additional information on the capital lease, see Note 8 – Commitments and Contingencies.

NOTE 6—INTANGIBLE ASSETS AND GOODWILL

The Company conducted its annual impairment test of goodwill as of June 30, 2016 and determined that there was no impairment. The Company also tests its intangible assets and goodwill between the annual impairment tests if events occur or circumstances change that would more likely than not reduce the fair value of the Company or its assets below their carrying amounts. For intangible assets subject to amortization, the Company performs its impairment test when indicators, such as reductions in demand or significant economic slowdowns, are present. No events have occurred since June 30, 2016 that would trigger further impairment testing of the Company's intangible assets and goodwill.

Amortization expenses for the three and six months ended June 30, 2016 totaled \$14,000 and \$28,000, respectively, and \$17,000 and \$35,000, respectively, for the same periods in 2015. Other intangible assets primarily include acquired customer lists and non-compete agreements.

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

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	As of June 30, 2016				As of December 31, 2015			
	Gross	Accumulated Amortization	Impairment	Net	Gross	Accumulated Amortization	Impairment	Net
Patents (4-10 years)	\$1,914	\$ (1,914)	\$ —	\$—	\$1,914	\$ (1,914)	\$ —	\$—
Trademarks (6 years)	69	(69)	—	—	69	(69)	—	—
Other (4 to 6 years)	817	(794)	—	23	817	(766)	—	51
Total	\$2,800	\$ (2,777)	\$ —	\$23	\$2,800	\$ (2,749)	\$ —	\$51
Goodwill (Indefinite life)	\$2,926			\$2,926	\$2,926			\$2,926

NOTE 7—ACCRUED LIABILITIES AND DEFERRED REVENUE

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

	June 30, 2016	December 31, 2015
Payroll and benefits	\$1,962	\$ 2,303
Warranty accrual, current portion	1,053	1,345
Taxes	531	445
Accrued professional services	773	681
Accrued capital lease and warranty obligations - current	169	167
Accrued insurance premium	147	467
Other	175	498
Total accrued liabilities	\$4,810	\$ 5,906

Changes in the initial product warranty accrual and the expenses incurred under the Company's initial and extended warranties for the three and six months ended June 30, 2016 and 2015 are included within accrued liabilities on the Consolidated Balance Sheets and were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Initial warranty accrual, beginning balance	\$2,060	\$1,667	\$2,188	\$1,449
Provision for estimated warranty cost	36	545	97	996
Warranty expenditures	(177)	(215)	(366)	(448)
	1,919	1,997	1,919	1,997
Less warranty accrual, long-term	866	868	866	868
Total warranty accrual, current portion	\$1,053	\$1,129	\$1,053	\$1,129

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

	June 30, 2016	December 31, 2015
Undelivered elements (training, installation, and product and support services)	\$1,637	\$ 1,608
Extended warranty contracts	1,405	1,428
Deferred royalties	201	261
Total Deferred Revenue	3,243	3,297
Less long-term amounts:		
Deferred royalties	82	142
Total Deferred Revenue - Long-Term	82	142
Total Deferred Revenue - Current	\$3,161	\$ 3,155

In connection with the Company's initiatives to measure and improve customer satisfaction and concurrent with the launch of WaterLase iPlus 2.0 in February 2015, the Company introduced its exclusive Practice Growth Guarantee, which is a program to assist with growth in the Company's clients' dental practices through training on a select number of clinical procedures and with billing and marketing support for dentists included. Consistent with the Company's standard terms and conditions applicable to all of its products, the Practice Growth Guarantee does not give the customer the right to return purchased laser systems or receive a refund of any amount of the purchase price. However, the Practice Growth Guarantee does provide for additional training opportunities and certain billing and marketing support activities to the customer. The Company has estimated additional deferred revenue related to the Practice Growth Guarantee for all WaterLase iPlus 2.0 system sales for the six months ending June 30, 2016 and June 30, 2015 to be approximately \$132,000 and \$94,000, respectively.

NOTE 8—COMMITMENTS AND CONTINGENCIES

Leases

The Company leases its 57,000 square foot corporate headquarters and manufacturing facility located at 4 Cromwell, Irvine, California. In March 2015, the corporate headquarters and manufacturing facility lease was amended to extend the term through April 30, 2020, modify provisions for a tenant improvement allowance of up to \$398,000, and adjust the basic rent terms. Future minimum rental commitments under operating lease agreements with non-cancelable terms greater than one year for the years ending December 31 are listed below. The Company also leases certain office equipment and automobiles under various operating lease arrangements.

In February 2015, the Company entered into a 30-month capital lease agreement for information technology equipment. Future minimum lease payments (using a 1.6% interest rate) under the capital lease, together with the present value of the net minimum lease payments, for the years ending December 31, 2016 and 2017 are \$71,000 and \$160,000, respectively. The current obligation with respect to the present value of net minimum lease payments of \$169,000 is reflected in the Consolidated Balance Sheets classified as an accrued liability, and the remaining portion of the present value of net minimum lease payments is classified as a long-term obligation within capital lease obligations in the amount of \$74,000, for the six months ended June 30, 2016.

Future minimum rental commitments under lease agreements, including both operating and capital leases (principle and interest), with non-cancelable terms greater than one year for each of the years ending December 31 are as follows (in thousands):

2016	\$443
2017	816
2018	619
2019	646
Thereafter	219
Total future minimum lease obligations	\$2,743

Employee arrangements and other compensation

Certain members of management are entitled to severance benefits payable upon termination following a change in control, which would approximate \$1.4 million, in the aggregate, at June 30, 2016. The Company also has agreements with certain employees to pay bonuses based on targeted performance criteria. As of at June 30, 2016, approximately \$75,000 was accrued for performance bonuses, which is included in accrued liabilities in the Consolidated Balance Sheets.

Purchase commitments

The Company generally purchases components and subassemblies for its products from a limited group of third party suppliers through purchase orders. As of June 30, 2016, the Company had \$12.7 million of purchase commitments for which the Company has not received certain goods or services that are expected to be purchased within one year. These purchase commitments were made to secure better pricing and to ensure the Company will have the necessary parts to meet anticipated near-term demand. Although open purchase orders are considered enforceable and legally binding, the Company may be able to cancel, reschedule, or adjust requirements prior to supplier fulfillment.

Litigation

The Company discloses material loss contingencies deemed to be reasonably possible and accrues for loss contingencies when, in consultation with its legal advisors, management concludes that a loss is probable and reasonably estimable. The ability to predict the ultimate outcome of such matters involves judgments, estimates, and inherent uncertainties. The actual outcome of such matters could differ materially from management's estimates.

Class Action Lawsuits

On August 23, 2013, a purported class action lawsuit entitled Brady Adams v. Biolase, Inc., et al., Case No. 13-CV-1300 JST (FFMx), was filed in the United States District Court for the Central District of California against BIOLASE and its then Chief Executive Officer, Federico Pignatelli, and its then Chief Financial Officer, Frederick D. Furry. On August 26, 2013, a purported class action lawsuit entitled Ralph Divizio v. Biolase, Inc., et al., Case No. 13-CV-1317 DMG (MRWx), was filed in the same court against BIOLASE, Messrs. Pignatelli and Furry, and its then President and Chief Operating Officer, Alexander K. Arrow. Each of the lawsuits alleges violations of the federal securities laws and asserts causes of action against the defendants under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. In accordance with the Private Securities Litigation Reform Act of 1995, on December 10, 2013, the court entered an order consolidating the lawsuits, appointing a lead plaintiff, and approving the lead plaintiff's selection of lead counsel. On February 24, 2014, the lead plaintiff filed a consolidated complaint against the Company and Messrs. Pignatelli, Furry, and Arrow, alleging violations of the federal securities laws and asserting causes of action against the defendants under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934.

On June 5, 2015, the United States District Court for the Central District of California approved, on a preliminary basis, the settlement of the consolidated securities class action lawsuit. The hearing on the final approval of the settlement was held on October 9, 2015, and the court entered final judgment and ordered the case dismissed on October 30, 2015.

On February 24, 2016, a purported class action lawsuit entitled Dr. Charles Shulruff v. Biolase, Inc., Case No. 1:16-cv-02533, was filed in the United States District Court for the Northern District of Illinois. The case alleges that the Company violated the federal Telephone Consumer Protection Act (TCPA) and other related Illinois state statutes, by sending unsolicited marketing communications via fax machine to a Chicago dentist, Dr. Shulruff. The plaintiff and his counsel seek to certify a nation-wide class of comprised of other dentists who received the same or similar faxes from BIOLASE. BIOLASE responded to the case on April 14, 2016 and denied liability on all claims. BIOLASE also denies that class certification is appropriate. The case is still in its early stages and no discovery or substantive motion practice has yet been conducted.

Intellectual Property Litigation

On April 24, 2012, CAO Group, Inc. ("CAO") filed a lawsuit against the Company in the District of Utah for patent infringement of U.S. Patent No. 7,485,116 (the "116 Patent") regarding the Company's ezlase dental laser. On September 9, 2012, CAO filed its First Amended Complaint, which added claims for (1) business disparagement/injurious falsehood under common law and (2) unfair competition under 15 U.S.C. Section 1125(a). The additional claims stem from a press release that the Company issued on April 30, 2012, which CAO claims contained false statements that are disparaging to CAO and its diode product. The First Amended Complaint seeks injunctive relief, treble damages, attorneys' fees, punitive damages, and interest. On November 13, 2012, the Court stayed the lawsuit for 120 days to allow the United States Patent and Trademark Office (the "USPTO") to consider the Company's request for reexamination of the patent-in-suit. The USPTO granted the request to reexamine the asserted claims of the patent-in-suit and, on February 28, 2013, the Court stayed the lawsuit until the termination of the reexamination proceedings. On April 23, 2013, the USPTO issued an office action rejecting all of the asserted claims over the prior art, and CAO responded to the office action. On August 28, 2013, the USPTO issued an Action Closing Procedure, rejecting all of CAO's patent claims. CAO responded to the USPTO's ruling and on December 10, 2013, the USPTO issued a Right of Appeal Notice, finally rejecting some claims of the 116 Patent while finding that other claims appeared to be patentable. The Company appealed the USPTO's findings on January 9, 2014 and on January 27, 2014, the USPTO declined to reconsider the finding of certain claims as patentable and instructed the parties to proceed to appeal to the Patent Trial and Appeal Board (the "Patent Board"). On March 17, 2014, the Company filed its brief in support of its appeal of the USPTO's decision not to reject certain claims of the 116 Patent. On March 24, 2014, CAO filed its brief in support of its appeal of the USPTO's decision to reject certain claims of the 116 patent. On April 18, 2014, the Company filed a respondent brief in opposition to the CAO's appeal arguments. On May 30, 2014, both

parties filed rebuttal briefs in support of their appeals. On June 30, 2014, the Company requested an oral hearing before the Patent Board. On July 1, 2014, the Patent Board noted that request and docketed the case for consideration. A hearing on reconsideration was held in November 2014. On July 1, 2015, the Patent Board issued a decision that was generally favorable to the Company. On July 31, 2015, CAO requested

a rehearing of the decision. On November 27, 2015, the Patent Board issued its decision regarding CAO's request for rehearing, partially granting CAO's request. On January 27, 2016, CAO filed its Notice of Appeal to the United States Court of Appeals for the Federal Circuit for review of the Patent Board's decision dated July 1, 2015 and the Patent Board's decision regarding CAO's request for rehearing. CAO filed its opening appeal brief on June 1, 2016 and Biolase filed its responsive brief on July 25, 2016.

The Company filed a patent infringement lawsuit against Fotona dd. ("Fotona") in Düsseldorf District Court (the "Düsseldorf Court") on April 12, 2012 alleging infringement with respect to the Fotona Fidelis dental laser system. Fotona has denied liability and sought the reimbursement of statutory fees from the Company. Together with its response brief, Fotona also filed a nullity action against the patent in dispute, patent number EP 1 560 470. The nullity action is pending at the German Federal Patent Court (the "Patent Court"), Docket No. 1 Ni 58/13 (EP). On September 2, 2013, the Company filed its counterplea in the infringement proceedings and phrased its arguments defending the validity of the patent. These arguments were also the subject of the defense brief to the Patent Court in the parallel nullity action proceedings. On September 9, 2013, the Company filed its response to the Patent Court. Fotona filed a rejoinder on February 3, 2014, including its counterplea on nullity.

On April 29, 2014, the Düsseldorf Court rendered a first instance decision whereby Fotona must cease and desist from selling its Fidelis and Lightwalker dental laser systems, render accounts on past sales, recall respective products, and pay damages on infringement. Additionally, the Company was awarded statutory fees, court costs, and attorneys' fees. In Germany, damages can be calculated based on the profits made by the infringer after the formal announcement of the granting of a patent, in this case beginning January 1, 2009, without considering direct labor or any other operational costs. This could amount to several million euros. In the two additional first instance cases following the extension of the initial lawsuit against Fotona, the Düsseldorf Court also required the Company to provide a statutory bond totaling €146,000. Such bonds are traditionally imposed on foreign plaintiffs to cover all statutory, court, and attorneys' fees. Fotona submitted its responses to the action and filed respective invalidation actions against the rights of the Company.

Subsequent to the foregoing responses, on March 24, 2015 the parties reached an agreement to settle the foregoing litigation and to dismiss the litigation with prejudice. As part of the settlement, Fotona agreed to pay the Company a total of \$1.4 million, with \$550,000 payable within 10 days of March 24, 2015 and the remaining, \$825,000 payable in three increments of \$275,000 each to be paid no later than the first, second, and third anniversary of the effective date of the agreement. Pursuant to the settlement agreement, the Company (i) granted Fotona a three-year, non-exclusive, paid-up license in the United States market and a five-year, non-exclusive, paid-up license in markets outside of the United States and (ii) agreed to grant Fotona a non-exclusive, royalty-based license following the expiration of the paid-up licenses. The Company calculated the present value of the settlement amount to be \$1.2 million and allocated such amount to each significant element of the settlement on a relative fair value basis. \$731,000 and \$68,000 were allocated towards the recovery of the Company's legal expenses and as settlement for the dismissal of the patent infringement lawsuit and are reflected as legal settlement and license fees and royalty revenue, respectively, on the Consolidated Statements of Operations and Comprehensive Loss. The remaining amount of \$379,000 was allocated towards the three-year, non-exclusive, paid-up license in the United States market and the five-year, non-exclusive, paid-up license in markets outside of the United States which was reflected within other assets and long-term deferred revenue on the Consolidated Balance Sheets. The deferred revenue is being recognized as license revenue over the terms of the paid-up licenses.

NOTE 9—SEGMENT INFORMATION

The Company currently operates in a single business segment. Management uses one measurement of profitability and does not segregate its business for internal reporting. For the three and six months ended June 30, 2016, sales to customers in the United States accounted for approximately 65% and 62% of net revenue, respectively, and international sales accounted for approximately 35% and 38% of net revenue, respectively. For the three and six months ended June 30, 2015, sales in the United States accounted for approximately 62% and 59% of net revenue, respectively, and international sales accounted for approximately 38% and 41% of net revenue, respectively. No individual country, other than the United States, represented more than 10% of total net revenue during the three and six months ended June 30, 2016 or 2015.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
United States	\$8,986	\$7,386	\$15,387	\$13,316
International	4,824	4,483	9,433	9,408
	\$13,810	\$11,869	\$24,820	\$22,724

Long-lived assets by geographic location was as follows (in thousands):

	June 30, 2016	December 31, 2015
United States	\$3,669	\$ 3,401
International	325	326
	\$3,994	\$ 3,727

NOTE 10—CONCENTRATIONS

Revenue from the Company's products for the three and six months ended June 30, 2016 and 2015 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Laser systems	70.7 %	65.6 %	67.0 %	65.1 %
Imaging systems	5.0 %	4.5 %	5.6 %	3.8 %
Consumables and other	12.5 %	15.9 %	14.1 %	16.7 %
Services	11.4 %	13.7 %	13.0 %	13.8 %
License fees and royalties	0.4 %	0.3 %	0.3 %	0.6 %
Total revenue	100.0%	100.0%	100.0%	100.0%

No individual customer represented more than 10% of the Company's revenue for the three and six months ended June 30, 2016 or 2015.

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

As of June 30, 2016, one customer represented 10.5% of the Company's accounts receivable. Amounts due are expected to be collected in full by the Company. No individual customer represented more than 10% of the Company's accounts receivable at December 31, 2015.

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

NOTE 11—INCOME TAXES

The Company accounts for income taxes under the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Management evaluates the need to establish a valuation allowance for deferred tax assets based upon the amount of existing temporary differences, the period in which they are expected to be recovered, and expected levels of taxable income. A valuation allowance to reduce deferred tax assets is established when it is “more likely than not” that some or all of the deferred tax assets will not be realized. Based on the Company’s net losses in prior years, management has determined that a full valuation allowance against the Company’s net deferred tax assets is appropriate.

Accounting for uncertainty in income taxes prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company has elected to classify interest and penalties as a component of its income tax provision. With respect to the liability for unrecognized tax benefits, including related estimates of penalties and interest, the Company did not record a liability for unrecognized tax benefits for the three and six months ended June 30, 2016 and 2015. The Company does not expect any changes to its unrecognized tax benefit for the next twelve months that would materially impact its consolidated financial statements.

During the three and six months ended June 30, 2016, the Company recorded an income tax provision of \$37,000 and \$77,000, respectively, resulting in an effective tax rate of (1.1)% and (1.0)%, respectively. During the three and six months ended June 30, 2015, the Company recorded an income tax provision of \$36,000 and \$83,000, respectively, resulting in an effective tax rate of (0.5)% and (0.7)%, respectively. The income tax provisions for the three and six months ended June 30, 2016 and 2015 were calculated using the discrete year-to-date method. The effective tax rate differs from the statutory tax rate of 34% primarily due to the existence of valuation allowances against net deferred tax assets and current liabilities resulting from the estimated state income tax liabilities and foreign tax liability.

NOTE 12—SUBSEQUENT EVENTS

On August 1, 2016, the Company entered into a securities purchase agreement with several institutional and individual investors, and certain of its directors and officers, under which the Company agreed to sell an aggregate of 88,494 unregistered shares of its convertible preferred stock at the price of \$113.00 per share, and warrants to purchase up to an aggregate of 2,035,398 unregistered shares of its common stock at an exercise price of \$2.00 per share. Each share of preferred stock will initially be convertible into 100 shares of common stock, reflecting a conversion price equal to \$1.13, the closing price of the Company’s common stock quoted on NASDAQ on July 29, 2016. The warrants become exercisable on February 8, 2017, six months after the closing of the private placement, and have a term of five years from the date of issuance. Following the closing, the Company will be required to hold a meeting of its stockholders in order to, among other things, satisfy NASDAQ requirements with respect to the issuance of common stock upon conversion of the convertible preferred stock and exercise of the warrants. The

conversion of the preferred stock will occur automatically upon receipt of such stockholder approval. In addition, the Company agreed to use commercially reasonable efforts to file, within 30 days following receipt of the stockholder approval, a registration statement with the Securities and Exchange Commission to register the resale of the shares of common stock underlying the preferred stock and warrants.

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

The following information should be read in conjunction with the unaudited consolidated financial statements and related notes of BIOLASE, Inc. ("BIOLASE") and its consolidated subsidiaries (together with BIOLASE, the "Company," "we," "our," or "us") included elsewhere in this Quarterly Report on Form 10-Q (this "Form 10-Q") and our audited consolidated financial statements and related notes included in the Annual Report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission (the "SEC") on March 11, 2016 (the "2015 Form 10-K"). In addition to historical information, this discussion and analysis contains "forward-looking statements" as defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such forward-looking statements include any statements, predictions, or expectations regarding our plans to expand product line, operating expenses, anticipated cash needs, needs for additional financing, use of working capital, anticipated trends and challenges in our business and the markets in which we operate, plans to explore potential collaborations, effects of engineering and development efforts, critical accounting policies, the impact of recent accounting pronouncements, recording tax benefits or other financial items in the future, plans, strategies, expectations or objectives of management for future operations, our financial condition or prospects, and any other statement that is not historical fact. Forward-looking statements are identified by the use of words such as "may," "might," "will," "intend," "should," "could," "can," "would," "continue," "expect," "believe," "anticipate," "predict," "potential," "plan," "seek," and similar expressions and variations or the negativities of these terms or other comparable terminology.

The forward-looking statements contained in this Item 2 are based on the expectations, estimates, projections, beliefs, and assumptions of our management based on information available to management as of the date on which this Form 10-Q was filed with the SEC, all of which are subject to change. Forward-looking statements are subject to risks, uncertainties, and other factors that are difficult to predict and could cause actual results to differ materially from those stated or implied by our forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to:

- global economic uncertainty and volatility in financial markets;
- inability to raise additional capital on terms acceptable to us;
- our relationships with, and the efforts of, third-party distributors;
- failure in our efforts to train dental practitioners or to overcome the hesitation of dentists and patients to adopt laser technologies;
- inconsistencies between future data and our clinical results;
- competition from other companies, including those with greater resources;
- our inability to successfully develop and commercialize enhanced or new products that remain competitive with products or alternative technologies developed by others;
- the inability of our customers to obtain third-party reimbursement for their use of our products;
- limitations on our ability to use net operating loss carryforwards;
- problems in manufacturing our products;
- warranty obligations if our products are defective;
- adverse publicity regarding our technology or products;
- adverse events to our patients during the use of our products, regardless of whether caused by our products;

- litigation, including the failure of our insurance policies to cover certain expenses relating to litigation and our inability to reach a final settlement related to certain litigations;
- issues with our suppliers, including the failure of our suppliers to supply us with a sufficient amount or adequate quality of materials;
- rapidly changing standards and competing technologies;
- our inability to effectively manage and implement our growth strategies;
- failure of our efforts to emphasize the importance of our imaging products to translate into increased sales of the same;
- risks associated with operating in international markets, including potential liabilities under the Foreign Corrupt Practices Act;
- breaches of our information technology systems;
- seasonality;
- disruptions to our operations at our primary facility;
- loss of our key management personnel or our inability to attract or retain qualified personnel;
- risks and uncertainties relating to acquisitions, including difficulties integrating acquired businesses successfully into our existing operations and risks of discovering previously undisclosed liabilities;
- failure to comply with the reporting obligations of the Exchange Act and Section 404 of the Sarbanes-Oxley Act of 2002, as amended or maintain adequate internal control over financial reporting;
- climate change initiatives;
- failure of our intellectual property rights to adequately protect our technologies and potential third-party claims that our products infringe their intellectual property rights;
- changes in government regulation or the inability to obtain or maintain necessary governmental approvals;
- our failure to comply with existing or new laws and regulations, including fraud and abuse and health information privacy and securities laws;
- changes in the Food and Drug Administration's ("FDA's") regulatory requirements applicable to laser products, dental devices, or both; and
- recall or other regulatory action concerning our products after receiving FDA clearance or approval.

Further information about factors that could materially affect the Company, including our results of operations and financial condition, is contained under "Risk Factors" in Item 1A in the 2015 Form 10-K. Except as required by law, we undertake no obligation to revise or update any forward-looking statements to reflect changed assumptions, the occurrence of anticipated or unanticipated events, new information or changes to future results over time or otherwise.

Overview

We are a medical device company that develops, manufactures, markets, and sells laser systems in dentistry and medicine and also markets, sells, and distributes dental imaging equipment, including cone beam digital x-rays and CAD/CAM intra-oral scanners, in-office, and chair-side milling machines. Our products advance the practice of dentistry and medicine for patients and health care professionals. Our proprietary dental laser systems allow dentists, periodontists, endodontists, oral surgeons, and other dental specialists to perform a broad range of minimally invasive dental procedures, including cosmetic, restorative, and complex surgical applications. Our laser systems are designed to provide clinically superior results for many types of dental procedures compared to those achieved with drills, scalpels, and other conventional instruments, in most cases without the need for local or general anesthesia. We have clearance from the FDA to market and sell our laser systems in the United States and also have the necessary registrations to market and sell our laser systems in Canada, the European Union, and many other countries outside the U.S. Additionally, our in-licensed imaging equipment and related products improve diagnoses, applications, and procedures in dentistry and medicine.

We offer two categories of laser system products: WaterLase (all-tissue) systems and Diode (soft tissue) systems. Our flagship brand, WaterLase, uses a patented combination of water and laser energy to perform most procedures currently performed using drills, scalpels, and other traditional dental instruments for cutting soft and hard tissue. We also offer our Diode laser systems to perform soft tissue, pain therapy, and cosmetic procedures, including teeth whitening. We have approximately 255 issued and 90 pending U.S. and international patents, the majority of which are related to WaterLase technology. From 1998 through June 30, 2016, we sold more than 32,000 laser systems in over 90 countries around the world. Contained in this total are over 11,500 WaterLase systems, including approximately 7,500 WaterLase MD and WaterLase iPlus systems. We were originally formed as Societe Endo Technic, SA (“SET”) in 1984 in Marseilles, France, to develop and market various endodontic and laser products. In 1987, SET merged into Pamplona Capital Corp., a public holding company incorporated in Delaware. In 1994, we changed our name to BIOLASE Technology, Inc., and in 2012, we changed our name to BIOLASE, Inc. Since 1998, we have been the global leading innovator, manufacturer, and marketer of dental laser systems.

Business and Outlook

Our WaterLase systems precisely cut hard tissue, bone, and soft tissue with minimal or no damage to surrounding tissue and dental structures. Our Diode systems, which include the EPIC system, are designed to complement our WaterLase systems, and are used only in soft tissue procedures, pain therapy, hygiene, and cosmetic applications, including teeth whitening. The Diode systems, together with our WaterLase systems, offer practitioners a broad product line with a range of features and price points.

We also manufacture and sell consumable products and accessories for our laser systems. Our WaterLase and Diode systems use disposable laser tips of differing sizes and shapes depending on the procedure being performed. We also market flexible fibers and hand pieces that dental practitioners replace at some point after initially purchasing laser systems. For our EPIC systems, we sell teeth whitening gel kits.

Due to the limitations associated with traditional and alternative dental instruments, we believe there is a large market opportunity for all-tissue dental laser systems that provide superior clinical outcomes, reduce the need to use anesthesia, help reduce trauma, pain, and discomfort associated with dental procedures, and increase patient acceptance for treatment protocols. We also believe there is a large market opportunity for digital radiography systems that improve practice efficiency and accuracy of diagnosis, leading to superior treatment planning, increased practice revenue, and healthier outcomes for patients.

Our strategy is to increase awareness and demand for (i) our products among dental practitioners by educating dental practitioners and patients about the clinical benefits of our product suite and (ii) our laser systems among patients by educating patients about the clinical benefits of the WaterLase and Diode systems. An important goal of ours is to increase consumables revenue by selling more single-use accessories used by dental practitioners when performing procedures using our dental laser systems. In the short term, we are striving for operating excellence through lean enterprise initiatives, with a specific focus on our sales strategy and cash flow management, coupled with optimizing our engineering capabilities to develop innovative new products.

We also seek to create value through innovation and leveraging existing technologies into adjacent medical applications. We plan to expand our product line and clinical applications by developing enhancements and transformational innovations, including new clinical solutions for dental applications and for other adjacent medical applications. In particular, we believe that our existing technologies can provide significant improvements over existing standards of care in fields including ophthalmology, otolaryngology, orthopedics, podiatry, pain management, aesthetics/dermatology, veterinary, and consumer products. We plan to continue to explore potential collaborations to bring our proprietary laser technologies with expanded FDA-cleared indications for other medical applications in the future.

Recent Developments

In February 2015, we launched the WaterLase iPlus 2.0, our next generation minimally invasive all-tissue flagship laser. In addition, we provided newly focused training programs on a select number of clinical procedures and support for billing and marketing. In November 2015, we announced an upgrade to the WaterLase iPlus 2.0 to provide dental practitioners a clinical protocol and application to assist in the effective management of peri-implantitis. A growing problem in dentistry, peri-implantitis is a destructive inflammatory process affecting the soft and hard tissues surrounding dental implants. With the addition of the new step-by-step clinical protocol, the WaterLase iPlus 2.0 provides pre-programmed settings and applications for more than 50 FDA-cleared procedures and clinical indications. The WaterLase iPlus 2.0 includes innovations and improvements designed to enhance patients' and dentists' experiences and generate practice growth for dental practitioners through routine use.

The WaterLase iPlus 2.0 also marks the debut of the SureFire YSGG Delivery System ("SureFire"), which ensures greater uptime through enhanced precision, performance, and reliability. SureFire has redesigned optics that efficiently deliver precise laser energy with a replaceable, disposable shield for better dependability. SureFire offers improved clinical access and comfort with its minimally invasive flagship dental laser system and exclusive contra-angle hand-piece.

Critical Accounting Policies

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") which require us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and revenues and expenses reported during the period. Information with respect to our critical accounting policies that we believe could have the most significant effect on our reported results and require subjective or complex judgments by management is contained in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations", of the 2015 Form 10-K. There have been no significant changes during the six months ended June 30, 2016 in our critical accounting policies from those disclosed in Item 7 of the 2015 Form 10-K.

Results of Operations

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

	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Products and services revenue	99.6 %	99.7 %	99.7 %	99.4 %
License fees and royalty revenue	0.4 %	0.3 %	0.3 %	0.6 %
Net revenue	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenue	59.0 %	68.8 %	62.5 %	69.6 %
Gross profit	41.0 %	31.2 %	37.5 %	30.4 %
Operating expenses:				
Sales and marketing	32.5 %	40.0 %	33.4 %	41.8 %
General and administrative	19.2 %	33.0 %	19.8 %	28.6 %
Engineering and development	13.8 %	16.6 %	15.3 %	16.6 %
Excise tax	0.0 %	0.8 %	0.0 %	0.7 %
Legal settlement	0.0 %	0.0 %	0.0 %	(3.2 %)
Total operating expenses	65.5 %	90.4 %	68.5 %	84.5 %
Loss from operations	(24.5 %)	(59.2 %)	(31.0 %)	(54.1 %)
Non-operating loss, net	(0.8 %)	0.2 %	(0.1 %)	(0.4 %)
Loss before income tax provision	(25.3 %)	(59.0 %)	(31.1 %)	(54.5 %)
Income tax provision	0.3 %	0.3 %	0.3 %	0.4 %
Net loss	(25.6 %)	(59.3 %)	(31.4 %)	(54.9 %)

Non-GAAP Disclosure

In addition to the financial information prepared in conformity with GAAP, we provide certain historical non-GAAP financial information. Management believes that these non-GAAP financial measures assist investors in making comparisons of period-to-period operating results and that, in some respects, these non-GAAP financial measures are more indicative of the Company's ongoing core operating performance than their GAAP equivalents.

Management believes that the presentation of this non-GAAP financial information provides investors with greater transparency and facilitates comparison of operating results across a broad spectrum of companies with varying capital structures, compensation strategies, derivative instruments, and amortization methods, which provides a more complete understanding of our financial performance, competitive position, and prospects for the future. However, the non-GAAP financial measures presented in this Form 10-Q have certain limitations in that they do not reflect all of the costs associated with the operations of our business as determined in accordance with GAAP. Therefore, investors should consider non-GAAP financial measures in addition to, and not as a substitute for, or as superior to, measures of financial performance prepared in accordance with GAAP. Further, the non-GAAP financial measures presented by the Company may be different from similarly named non-GAAP financial measures used by other companies.

Non-GAAP Net Loss

Management uses non-GAAP net loss (defined as net loss before interest, taxes, depreciation and amortization, stock-based compensation, other equity instruments, and other non-cash compensation) in its evaluation of the Company's core results of operations and trends between fiscal periods and believes that these measures are important components of its internal performance measurement process. Management believes that this non-GAAP financial information reflects an additional way of viewing aspects of our business that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our business. The following table contains a reconciliation of non-GAAP net loss to GAAP net loss (in thousands).

	Three Months Ended		Six Months Ended	
	June 30, 2016	2015	June 30, 2016	2015
GAAP net loss, as reported	\$(3,533)	\$(7,041)	\$(7,798)	\$(12,477)
Adjustments:				
Interest income, net	(17)	(23)	(34)	(23)
Income tax provision	37	36	77	83
Depreciation and amortization	276	166	488	324
Stock-based, other equity instruments, and other non-cash compensation	946	935	1,780	1,635
Non-GAAP net loss	\$(2,291)	\$(5,927)	\$(5,487)	\$(10,458)

Comparison of Results of Operations

Three months ended June 30, 2016 and 2015

Net Revenue: The following table summarizes our net revenues by category, including each category's percentage of our total revenue, for the three months ended June 30, 2016 ("Second Quarter 2016") and the three months ended June 30, 2015 ("Second Quarter 2015"), as well as the amount of change and percentage of change in each revenue category (dollars in thousands):

	Three Months Ended		Three Months Ended		Amount Change	Percent Change
	June 30, 2016	2015	June 30, 2015	2016		
Laser systems	\$9,770	70.7 %	\$7,786	65.6 %	\$ 1,984	25.5 %
Imaging systems	687	5.0 %	533	4.5 %	154	28.9 %
Consumables and other	1,722	12.5 %	1,890	15.9 %	(168)	(8.9 %)
Services	1,576	11.4 %	1,626	13.7 %	(50)	(3.1 %)
Total products and services	13,755	99.6 %	11,835	99.7 %	1,920	16.2 %
License fees and royalty	55	0.4 %	34	0.3 %	21	61.8 %
Net revenue	\$13,810	100.0 %	\$11,869	100.0 %	\$ 1,941	16.4 %

Typically, we experience fluctuations in revenue from quarter to quarter due to seasonality. Revenue in the first quarter typically is lower than average and revenue in the fourth quarter typically is stronger than average due to the

buying patterns of dental practitioners. We believe that this trend exists because a significant number of dentists purchase their capital equipment towards the end of the calendar year in order to maximize their practice earnings while seeking to minimize their taxes. They often use certain tax incentives, such as accelerated depreciation methods for purchasing capital equipment, as part of their year-end tax planning. In addition, revenue in the third quarter may be affected by vacation patterns which can cause revenue to be flat or lower than in the second quarter of the year. Our historical seasonal fluctuations may also be impacted by sales promotions used by large dental distributors that encourage end-of-quarter and end-of-year buying in our industry.

Total revenue by geographic location based on the location of customers for the three months ended June 30, 2016 and 2015, as well as the amount of change and percentage of change in each geographic revenue category, was as follows (dollars in thousands):

	Three Months Ended June 30, 2016		Three Months Ended June 30, 2015		Amount Change	Percent Change
United States	\$8,986	65.1 %	\$7,386	62.2 %	\$ 1,600	21.7 %
International	4,824	34.9 %	4,483	37.8 %	341	7.6 %
Net revenue	\$ 13,810	100.0 %	\$ 11,869	100.0 %	\$ 1,941	16.4 %

The overall increase in period-over-period net revenue resulted primarily from laser systems sales, which increased by \$2.0 million, or 26%, in the Second Quarter 2016 compared to the Second Quarter 2015. Sales of our core laser products improved 36% domestically and 11% internationally, largely resulting from the continued realization associated with changes to our sales cycle that were implemented late in 2015. Further contributors to the sales improvement were international sales of imaging systems, which increased by 66% driving the \$154,000 increase in overall imaging sales, and domestic sales of license and royalty revenue which increased by 62% on a relatively small base for an overall increase of \$21,000.

Partially offsetting the increased laser, imaging, and license and royalty revenue was internationally driven decreases in consumables and other revenue of \$168,000, or 9%, and in services revenue, which consists of extended warranty service contracts, advanced training programs, and other services, of \$50,000, or 3%, during the Second Quarter 2016 compared to the Second Quarter 2015.

Cost of Revenue and Gross Profit: The following table summarizes our cost of revenue and gross profit for the Second Quarter 2016 and the Second Quarter 2015, as well as the amount of change and percentage of change (dollars in thousands):

	Three Months Ended June 30, 2016		Three Months Ended June 30, 2015		Amount Change	Percent Change
Net revenue	\$ 13,810	100.0 %	\$ 11,869	100.0 %	\$ 1,941	16.4 %
Cost of revenue	8,154	59.0 %	8,168	68.8 %	(14)	(0.2 %)
Gross profit	\$ 5,656	41.0 %	\$ 3,701	31.2 %	\$ 1,955	52.8 %

Gross profit as a percentage of revenue typically fluctuates with product and regional mix, selling prices, product costs and revenue levels. The 53% improvement in gross profit as a percentage of revenue for the Second Quarter 2016, as compared to Second Quarter 2015, reflected a larger mix of domestic laser sales, which typically have higher product margins due to higher pricing.

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Operating Expenses: The following table summarizes our operating expenses as a percentage of net revenue for the three months ended June 30, 2016 and 2015, as well as the amount of change and percentage of change (dollars in thousands):

	Three Months Ended June 30, 2016		Three Months Ended June 30, 2015		Amount Change	Percent Change
Sales and marketing	\$4,488	32.5%	\$4,743	40.0%	\$(255)	(5.4 %)
General and administrative	2,655	19.2%	3,916	33.0%	(1,261)	(32.2 %)
Engineering and development	1,900	13.8%	1,974	16.6%	(74)	(3.7 %)
Excise tax	-	- %	97	0.8 %	(97)	(100.0 %)
Total operating expenses	\$9,043	65.5%	\$10,730	90.4%	\$(1,687)	(15.7 %)

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The \$1.7 million or 16% overall decrease in period-over-period operating expenses is explained in the following expense categories:

Sales and Marketing Expense. Sales and marketing expenses in the Second Quarter 2016 compared to the Second Quarter 2015 decreased by \$255,000, or 5%, primarily due to a \$253,000 decrease in media, advertising, and printing expenses and a \$137,000 decrease in supplies, partially offset by an increase of \$53,000 in commissions, and a \$71,000 increase in convention and travel related expenses. The overall decrease in sales and marketing expenses during the Second Quarter 2016 was as expected following the Company's organizational restructuring changes and cost cutting measures implemented during the second half of 2015. The Company plans to continue to focus on (i) enhancing customer acquisition, retention, and global brand awareness, and (ii) rebuilding our sales and marketing team domestically and internationally. As we strive to transform and return to revenue growth, we expect sales and marketing expenses to decrease as a percentage of revenue during 2016.

General and Administrative Expense. General and administrative expenses in the Second Quarter 2016 compared to the Second Quarter 2015 decreased by \$1.3 million, or 32%, primarily due to a \$305,000 decrease in bad debt, a \$285,000 decrease in payroll and consulting related expenses, a \$180,000 decrease in investor relations, a \$150,000 decrease in patent and legal expenses, a \$71,000 decrease in stock-based compensation, and a \$39,000 decrease in supplies. The reduced payroll and consulting related expenses is primarily due to the severance and recruiting expenses related to the change in CEO which occurred during the Second Quarter 2015. We expect general and administrative expenses to continue to decrease as a percentage of revenue through 2016.

Engineering and Development Expense. Engineering and development expenses in the Second Quarter 2016 compared to the Second Quarter 2015 decreased by \$74,000, or 4%, primarily due to a \$275,000 decrease in operating supplies, partially offset by a \$139,000 increase in payroll and consulting related expenses and a \$52,000 increase in stock-based compensation expense. We expect to increase our investment in engineering and development activity as we continue our efforts on new product development for 2016.

Excise Tax Expense. Beginning in 2013, the Affordable Care Act imposed a 2.3% medical device excise tax on certain product sales to customers located in the U.S. Excise tax expenses for the Second Quarter 2016 was \$0, compared to \$97,000, or 0.8% of net revenue, for the Second Quarter 2015. The decrease of \$97,000 was directly associated with the Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act"), which suspended the medical device excise tax for calendar years 2016 and 2017. Due to the PATH Act, we do not anticipate any excise tax expenses on our products during 2016.

Gain (Loss) on Foreign Currency Transactions. We realized a \$126,000 loss on foreign currency transactions during the Second Quarter 2016, compared to a \$1,000 gain on foreign currency transactions during the Second Quarter 2015 due to exchange rate fluctuations between the U.S. dollar and other currencies, primarily the Euro.

Interest Income (Expense), Net. Interest income during the Second Quarter 2016 represented interest recognized from the discounted present value of the settlement in connection with the patent infringement lawsuit against Fotona Proizvodnja Optoelektronskih Naprav D.D. and Fotona LLC (collectively, "Fotona") that we filed in Düsseldorf District Court in April 2012 alleging infringement with respect to the Fotona Fidelis dental laser system (the "Fotona Litigation").

Income Tax Provision (Benefit). We use a discrete year-to-date method in calculating quarterly provision for income taxes. Our provision for income taxes was \$37,000 for Second Quarter 2016, compared to a provision of \$36,000 for Second Quarter 2015. The increase of \$1,000, or 3%, in income tax provision was primarily due to a combination of additional state income tax expense recognized for the Second Quarter 2016 and a \$14,000 decrease in net foreign profit during the Second Quarter 2016 as compared to the Second Quarter 2015. For additional information regarding

income taxes, see Part I, Item I, Note 11 – Income Taxes.

Net Loss. Our net loss totaled approximately \$3.5 million for the Second Quarter 2016 compared to a net loss of \$7.0 million for the Second Quarter 2015. The \$3.5 million or 50% decrease in net loss was due to overall business improvements including a \$1.9 million increase in net revenue, a \$14,000 reduction in cost of revenue, and a \$1.7 million decrease in operating expenses.

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Six months ended June 30, 2016 and 2015

Net Revenue: The following table summarizes our net revenues by category, including each category's percentage of our total revenue, for the six months ended June 30, 2016 ("YTD Second Quarter 2016") and the six months ended June 30, 2015 ("YTD Second Quarter 2015"), as well as the amount of change and percentage of change in each revenue category (dollars in thousands):

	Six Months Ended June 30, 2016			Six Months Ended June 30, 2015			Amount Change	Percent Change
Laser systems	\$16,634	67.0 %		\$14,794	65.1 %		\$1,840	12.4 %
Imaging systems	1,379	5.6 %		874	3.8 %		505	57.8 %
Consumables and other	3,497	14.1 %		3,792	16.7 %		(295)	(7.8 %)
Services	3,224	13.0 %		3,126	13.8 %		98	3.1 %
Total products and services	24,734	99.7 %		22,586	99.4 %		2,148	9.5 %
License fees and royalty	86	0.3 %		138	0.6 %		(52)	(37.7 %)
Net revenue	\$24,820	100.0 %		\$22,724	100.0 %		\$2,096	9.2 %

Total revenue by geographic location based on the location of customers for the six months ended June 30, 2016 and 2015, as well as the amount of change and percentage of change in each geographic revenue category, was as follows (dollars in thousands):

	Six Months Ended June 30, 2016			Six Months Ended June 30, 2015			Amount Change	Percent Change
United States	\$15,387	62.0 %		\$13,316	58.6 %		\$2,071	15.6 %
International	9,433	38.0 %		9,408	41.4 %		25	0.3 %
Net revenue	\$24,820	100.0 %		\$22,724	100.0 %		\$2,096	9.2 %

The overall increase in period-over-period net revenue resulted primarily from laser systems sales, which increased by \$1.8 million, or 12%, in the YTD Second Quarter 2016 compared to the YTD Second Quarter 2015. The laser systems sales increase was driven by a 24% domestic improvement and a 1% international improvement. Imaging systems revenue also increased worldwide, with a 68% improvement domestically and a 41% improvement internationally, for an overall increase of \$505,000, or 58%. Rounding out the overall sales improvement was a \$98,000, or 3%, increase in services revenue due to the increased domestic focus on advanced training programs.

Partially offsetting the increased laser, imaging, and services revenue was a worldwide decrease in consumables of \$295,000, or 8%, and in domestic license and royalty revenue which decreased by \$52,000 or 38% during the YTD Second Quarter 2016 compared to the YTD Second Quarter 2015 due to our patent infringement lawsuit settlement

during the YTD Second Quarter 2015.

Cost of Revenue and Gross Profit: The following table summarizes our cost of revenue and gross profit for the six months ended June 30, 2016 and 2015, as well as the amount of change and percentage of change (dollars in thousands):

	Six Months Ended June 30, 2016		Six Months Ended June 30, 2015		Amount Change	Percent Change
Net revenue	\$24,820	100.0%	\$22,724	100.0%	\$ 2,096	9.2 %
Cost of revenue	15,520	62.5 %	15,813	69.6 %	(293)	(1.9 %)
Gross profit	\$9,300	37.5 %	\$6,911	30.4 %	\$ 2,389	34.6 %

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Gross profit as a percentage of revenue typically fluctuates with product and regional mix, selling prices, product costs and revenue levels. The 35% improvement in gross profit as a percentage of revenue for the YTD Second Quarter 2016, as compared to the YTD Second Quarter 2015, reflected a larger mix of domestic laser sales, which typically have higher product margins due to higher pricing.

Operating Expenses: The following table summarizes our operating expenses as a percentage of net revenue for the six months ended June 30, 2016 and 2015, as well as the amount of change and percentage of change (dollars in thousands):

	Six Months Ended June 30, 2016		Six Months Ended June 30, 2015		Amount Change	Percent Change
Sales and marketing	\$8,292	33.4%	\$9,497	41.8%	\$(1,205)	(12.7%)
General and administrative	4,922	19.8%	6,503	28.6%	(1,581)	(24.3%)
Engineering and development	3,786	15.3%	3,777	16.6%	9	0.2%
Excise tax	-	-%	153	0.7%	(153)	(100.0%)
Legal settlement	-	-%	(731)	(3.2%)	731	(100.0%)
Total operating expenses	\$17,000	68.5%	\$19,199	84.5%	\$(2,199)	(11.5%)

The \$2.2 million or 12% overall decrease in period-over-period operating expenses is explained in the following expense categories:

Sales and Marketing Expense. Sales and marketing expenses in the YTD Second Quarter 2016 compared to the YTD Second Quarter 2015 decreased by \$1.2 million, or 13%, primarily due to a \$521,000 decrease in media, advertising, and printing expenses, a \$226,000 decrease in payroll and consulting related expenses, a \$166,000 decrease in stock-based compensation expenses, a \$122,000 decrease in supplies expense, and a \$99,000 decrease in convention and travel related expenses. The overall decrease in sales and marketing expenses during the YTD Second Quarter 2016 was as expected following the Company's organizational restructuring changes and cost cutting measures implemented during the second half of 2015. The Company plans to continue to focus on (i) enhancing customer acquisition, retention, and global brand awareness, and (ii) rebuilding our sales and marketing team domestically and internationally. As we strive to transform and return to revenue growth, we expect sales and marketing expenses to decrease as a percentage of revenue during 2016.

General and Administrative Expense. General and administrative expenses in the YTD Second Quarter 2016 compared to the YTD Second Quarter 2015 decreased by \$1.6 million, or 24%, primarily due to a \$638,000 decrease in payroll and consulting related expenses, a \$423,000 decrease in patent and legal expenses, a \$374,000 decrease in bad debt expense, and a \$161,000 decrease in investor relations expense. The decline in payroll and consulting related expenses is primarily due to the severance and recruiting expenses related to the change in CEO and CFO for the YTD Second Quarter 2015. The decrease in patent and legal expenses resulted from the settlement of our patent infringement lawsuit during the YTD Second Quarter 2015. We expect general and administrative expenses to continue to decrease as a percentage of revenue through 2016.

Engineering and Development Expense. Engineering and development expenses in the YTD Second Quarter 2016 compared to the YTD Second Quarter 2015 increased by \$9,000, or 0.2%, resulting from our focused efforts to accelerate innovation of both our existing products and technologies as well as to develop new products and

technologies, which we believe will further strengthen our worldwide leadership position. We expect to increase our investment in engineering and development activity as we continue our efforts on new product development during 2016.

Excise Tax Expense. Beginning in 2013, the Affordable Care Act imposed a 2.3% medical device excise tax on certain product sales to customers located in the U.S. Excise tax expenses for the YTD Second Quarter 2016 was \$0, compared to \$153,000, or 0.7% of net revenue, for the YTD Second Quarter 2015. The decrease of \$153,000 was directly associated with the Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act"), which suspended the medical device excise tax for calendar years 2016 and 2017. Due to the PATH Act, we do not anticipate any excise tax expenses on our products during 2016.

Legal Settlement. On March 24, 2015, we entered into a settlement agreement with Fotona in the Fotona Litigation, at which time we recorded a \$731,000 credit toward the recovery of our legal expenses. For a more detailed discussion of the intellectual property litigation, see Part I, Item I, Note 8 – Commitments and Contingencies.

Gain (Loss) on Foreign Currency Transactions. We realized a \$55,000 loss on foreign currency transactions during the YTD Second Quarter 2016, compared to a \$129,000 loss on foreign currency transactions during the YTD Second Quarter 2015 due to exchange rate fluctuations between the U.S. dollar and other currencies, primarily the Euro.

Interest Income (Expense), Net. Interest income during the YTD Second Quarter 2016 represented interest recognized from the discounted present value of the settlement in connection with the Fotona Litigation.

Income Tax Provision (Benefit). We use a discrete year-to-date method in calculating YTD quarterly provision for income taxes. Our provision for income taxes was \$77,000 for YTD Second Quarter 2016, compared to a provision of \$83,000 for YTD Second Quarter 2015. The decrease of \$6,000, or 7%, in income tax provision was primarily due to a \$39,000 decrease in net foreign profit during the YTD Second Quarter 2016 as compared to the YTD Second Quarter 2015. For additional information regarding income taxes, see Part I, Item I, Note 11 – Income Taxes.

Net Loss. Our net loss totaled approximately \$7.8 million for the YTD Second Quarter 2016 compared to a net loss of \$12.5 million for the YTD Second Quarter 2015. The \$4.7 million or 38% decrease in net loss was due to overall business improvements including a \$2.1 million increase in net revenue, a \$293,000 reduction in cost of revenue, and a \$2.2 million decrease in operating expenses.

Liquidity and Capital Resources

At June 30, 2016, the Company had approximately \$5.1 million in cash and cash equivalents. Management defines cash and cash equivalents as highly liquid deposits with original maturities of 90 days or less when purchased. The decrease in our cash and cash equivalents of \$6.8 million at June 30, 2016 as compared to December 31, 2015, was primarily due to cash used in operating, investing, and financing activities of \$6.3 million, \$502,000, and \$86,000 respectively, offset by the effect of exchange rates on cash of \$41,000. The \$6.3 million of net cash used in operating activities was driven by the Company's net loss of \$7.8 million for the YTD Second Quarter.

The following table summarizes our change in cash and cash equivalents (in thousands):

	Six Months Ended	
	June 30,	
	2016	2015
Net cash flows used in operating activities	\$(6,275)	\$(11,039)
Net cash flows used in investing activities	(502)	(433)
Net cash flows provided by (used by) financing activities	(86)	2
Effect of exchange rate changes	41	(168)
Net change in cash and cash equivalents	\$(6,822)	\$(11,638)

Operating Activities

Net cash used in operating activities consists of our net loss, adjusted for our non-cash charges, plus or minus working capital changes. Cash used in operating activities for the YTD Second Quarter 2016, totaled \$6.3 million and was primarily comprised of our net loss of \$7.8 million, partially offset by non-cash adjustments for stock-based compensation expenses of \$1.8 million and depreciation and amortization expenses of \$488,000. The \$657,000 net decrease in our operating assets and liabilities was primarily due to an increase in accounts receivable of \$2.0 million related to the timing of our collections, a decrease in deferred revenue of \$54,000 resulting from less deferred services revenue, and a decrease in customer deposits of \$19,000, partially offset by a decrease in inventory of \$908,000, a decrease in prepaid expenses and other current assets of \$451,000, and an increase in accounts payable and accrued liabilities of \$25,000 related to the timing of our payments.

Investing Activities

Cash used in investing activities for the YTD Second Quarter 2016 consisted of \$502,000 of capital expenditures. The period-over-period increase is primarily due to construction in progress purchases during the Second Quarter 2016 and payment of First Quarter 2016 purchases associated with implementation of a new ERP system.

Financing Activities

Net cash used in financing activities for the YTD Second Quarter 2016 of \$86,000 resulted from payments on our capital lease obligations. The period-over-period decrease is primarily due to there not being any proceeds from the exercise of stock options and warrants during the YTD Second Quarter 2016.

Effect of Exchange Rate

The \$41,000 effect of exchange rate on cash for the YTD Second Quarter 2016 was primarily due to a recognized gain on foreign currency transactions due to a stronger Euro compared to the YTD Second Quarter 2015.

Future Liquidity Needs

As of June 30, 2016, the Company had working capital of approximately \$13.6 million. Our principal sources of liquidity as of June 30, 2016 consisted of approximately \$5.1 million in cash, cash equivalents and restricted cash and \$11.0 million of net accounts receivable.

In order for us to continue operations beyond the next 12 months and be able to discharge our liabilities and commitments in the normal course of business, we must increase sales of our products directly to end-users and through distributors, establish profitable operations through the combination of increased sales and decreased expenses, and generate cash from operations or obtain additional funds when needed. We intend to improve our financial condition and ultimately improve our financial results by increasing revenues through expansion of our product offerings, continuing to expand and develop our fields sales force and distribution relationships both domestically and internationally, forming strategic arrangements within the dental and medical industries, educating dental and medical patients as to the benefits of our advanced medical technologies, and reducing expenses. Additional capital requirements may depend on many factors, including, among other things, continued losses, the rate at which our business grows, demands for working capital, manufacturing capacity, and any acquisitions that we may pursue. From time to time, we could be required, or may otherwise attempt, to raise capital, through either equity or debt offerings, or enter into a line of credit facility. We cannot provide assurance that we will be able to successfully enter into any such equity or debt financings or line of credit facility in the future or that the required capital would be available on acceptable terms, if at all, or that any such financing activity would not be dilutive to our stockholders.

Recent Accounting Pronouncements

For a description of recently issued and adopted accounting pronouncements, including the respective dates of adoption and expected effects on our results of operations and financial condition, please refer to Part I, Item 1, Note 2 – Summary of Significant Accounting Policies, which is incorporated herein by this reference.

Additional Information

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in the information disclosed in Part II, Item 7a “Quantitative and Qualitative Disclosures about Market Risk” in the 2015 Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

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

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For a description of our legal proceedings, please refer to Part I, Item 1, Note 8 – Commitments and Contingencies, which is incorporated herein by reference in response to this Item.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors as disclosed in Part I, Item 1A “Risk Factors” in the 2015 Form 10-K.

ITEM 6. EXHIBITS

Exhibit	Description	Filed Herewith	Incorporated by Reference			
			Form	Period Ending/Date of Report	Filing Exhibit Date	
3.1.1	Restated Certificate of Incorporation, including, (i) Certificate of Designations, Preferences and Rights of 6% Redeemable Cumulative Convertible Preferred Stock of the Registrant; (ii) Certificate of Designations, Preferences and Rights of Series A 6% Redeemable Cumulative Convertible Preferred Stock of the Registrant; (iii) Certificate of Correction Filed to Correct a Certain Error in the Certificate of Designation of the Registrant; and (iv) Certificate of Designations of Series B Junior Participating Cumulative Preferred Stock of the Registrant.		S-1, Amendment No. 1	12/23/2005	3.1	12/23/2005
3.1.2	Amendment to Restated Certificate of Incorporation		8-K	05/10/2012	3.1	05/16/2012
3.1.3	Second Amendment to Restated Certificate of Incorporation		8-A/A	11/04/2014	3.1.3	11/04/2014