CUTERA INC
Form 10-Q
August 04, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2008

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period ______ to ______.

Commission file number: 000-50644

Cutera, Inc.

(Exact name of registrant as specified in its charter)

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

3240 Bayshore Blvd., Brisbane, California 94005

(Address of principal executive offices)

(415) 657-5500

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 definitions 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 x Non-accelerated filer ¨ Smaller reporting company ¨

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

The number of shares of Registrant s common stock issued and outstanding as of July 31, 2008 was 12,779,692.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CUTERA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

(unaudited)

	June 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 20,464	$ 11,054
Marketable investments	75,872	88,510
Accounts receivable, net	9,157	10,692
Inventories	8,609	7,533
Deferred tax asset	7,899	8,058
Other current assets	2,137	1,955
Total current assets	124,138	127,802
Property and equipment, net	1,232	1,361
Long term investments	11,478	7,429
Intangibles, net	1,126	1,227
Deferred tax asset, net of current portion	1,021	834
Total assets	$ 138,995	$ 138,653
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 1,914	$ 2,350
Accrued liabilities	11,664	13,587
Deferred revenue	5,943	4,971
Total current liabilities	19,521	20,908
Deferred rent	1,676	1,639
Deferred revenue, net of current portion	5,891	5,593
Income tax liability	1,558	1,160
Total liabilities	28,646	29,300
Commitments and contingencies (Note 8)		
Stockholders equity:		
Common stock	13	13
Additional paid-in capital	77,737	74,871
Retained earnings	34,398	34,279
Accumulated other comprehensive income (loss)	(1,799)	190
Total stockholders equity	110,349	109,353

Total liabilities and stockholders equity	$ 138,995	$ 138,653

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

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CUTERA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net revenue	$ 24,754	$ 23,873	$ 46,372	$ 47,130
Cost of revenue	9,271	7,910	17,490	15,691
Gross profit	15,483	15,963	28,882	31,439
Operating expenses:				
Sales and marketing	10,361	9,190	20,710	18,253
Research and development	2,004	1,923	3,789	3,671
General and administrative	3,023	2,900	5,964	5,918
Total operating expenses	15,388	14,013	30,463	27,842
Income (loss) from operations	95	1,950	(1,581)	3,597
Interest and other income, net	857	1,108	1,758	2,110
Income before income taxes	952	3,058	177	5,707
Provision for income taxes	291	1,024	58	1,918
Net income	$ 661	$ 2,034	$ 119	$ 3,789
Net income per share:				
Basic	$ 0.05	$ 0.15	$ 0.01	$ 0.28
Diluted	$ 0.05	$ 0.14	$ 0.01	$ 0.26
Weighted-average number of shares used in per share calculations:				
Basic	12,764	13,610	12,753	13,413
Diluted	13,465	14,666	13,457	14,655

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

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CUTERA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Cash flows from operating activities:		
Net income	$ 119	$ 3,789
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation	2,657	2,788
Tax benefit (shortfall) related to employee stock options	(51)	1,497
Excess tax benefit related to stock-based compensation expense		(833)
Depreciation and amortization	451	454
Change in deferred tax asset	(28)	184
Other	106	153
Changes in assets and liabilities:		
Accounts receivable	1,446	378
Inventories	(1,093)	(1,681)
Other current assets	48	(113)
Accounts payable	(436)	(285)
Accrued liabilities	(1,923)	(807)
Deferred rent	37	107
Deferred revenue	1,270	1,184
Income tax liability	398	(56)
Net cash provided by operating activities	3,001	6,759
Cash flows from investing activities:		
Acquisition of property and equipment	(221)	(758)
Acquisition of intangibles		(20)
Proceeds from sales of marketable investments	41,195	18,669
Proceeds from maturities of marketable investments	9,670	17,253
Purchase of marketable and long term investments	(44,495)	(44,682)
Net cash provided by (used in) investing activities	6,149	(9,538)
Cash flows from financing activities:		
Proceeds from exercise of stock options and employee stock purchase plan	260	3,073
Repurchase of common stock		(2,516)
Excess tax benefit related to stock-based compensation expense		833
Net cash provided by financing activities	260	1,390
Net increase (decrease) in cash and cash equivalents	9,410	(1,389)
Cash and cash equivalents at beginning of period	11,054	11,800
Cash and cash equivalents at end of period	$ 20,464	$ 10,411

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Description of Operations and Principles of Consolidation.

Cutera, Inc. (Cutera or the Company) is a global provider of laser and other light-based aesthetic systems for practitioners worldwide. The Company designs, develops, manufactures, and markets the CoolGlide, Xeo and Solera product platforms for use by physicians and other qualified practitioners to offer safe and effective aesthetic treatments to their customers.

Headquartered in Brisbane, California, the Company has wholly-owned subsidiaries in Australia, Canada, France, Japan, Spain, Switzerland and United Kingdom that market, sell and service its products outside of the United States. The Condensed Consolidated Financial Statements include the accounts of the Company and its subsidiaries. All inter-company transactions and balances have been eliminated.

Unaudited Interim Financial Information

The financial information furnished is unaudited. The Condensed Consolidated Financial Statements included in this report reflect all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for the fair statement of the results of operations for the interim periods covered and of the financial condition of the Company at the date of the interim balance sheet. The December 31, 2007 Condensed Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The results for interim periods are not necessarily indicative of the results for the entire year or any other interim period. The Condensed Consolidated Financial Statements should be read in conjunction with the Company s financial statements and the notes thereto included in the Company s annual report on Form 10-K for the year ended December 31, 2007 filed with the Securities and Exchange Commission, or SEC, on March 13, 2008.

Use of Estimates

The preparation of interim Condensed Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States requires the Company s management to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. Actual results could differ materially from those estimates. On an ongoing basis, the Company evaluates their estimates, including those related to the accounts receivable and sales allowances, fair values of marketable and long term investments, fair values of acquired intangible assets, useful lives of intangible assets and property and equipment, fair values of options to purchase the Company s common stock, recoverability of deferred tax assets, and effective income tax rates, among others. Management bases their estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Significant Accounting Policies

The Company s significant accounting policies are disclosed in the Company s annual report on Form 10-K for the year ended December 31, 2007 and have not changed significantly as of June 30, 2008, except for the following:

Fair Value Measurements

On January 1, 2008, the Company adopted Statement of Financial Accounting Standards, or SFAS, No. 157, *Fair Value Measurements,* or SFAS 157, as it relates to financial assets and financial liabilities. In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 157-2, *Effective Date of FASB Statement No. 157,* which delayed the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on at least an annual basis, until January 1, 2009 for calendar year-end entities. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles in the United States of America, or GAAP, and expands disclosures about fair value measurements.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This standard is now the single source in GAAP for the definition of fair value, except for the fair value of leased property as defined in SFAS No. 13, *Accounting for Leases.* SFAS 157 establishes a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity s own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy under SFAS 157 are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Directly or indirectly observable inputs as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in the models, such as interest rates and volatility factors, are corroborated by readily observable data from actively quoted markets for substantially the full term of the financial instrument.

Level 3: Unobservable inputs that are supported by little or no market activity and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management s estimates of market participant assumptions.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as considers counterparty credit risk in its assessment of fair value. The following section describes the valuation methodologies used by the Company to measure different financial instruments at fair value, including an indication of the level in the fair value hierarchy in which each instrument is generally classified.

At June 30, 2008, the Company held $13.4 million (par value), with an estimated fair value of $11.5 million, of either AAA or Aa3 rated municipal bonds with an auction interest rate reset feature, known as auction rate securities, or ARS. The ARS held by the Company are guaranteed either by the Federal Family Education Loan

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Program or the Maine Education Loan Authority and were issued for the purpose of financing student loans. ARS have historically traded at par and are redeemable at par plus accrued interest at the option of the issuer. Interest is typically paid at the end of each auction period or semi-annually. Until February 2008, the market for the Company s ARS was highly liquid. Since February 2008, a substantial number of auctions failed, meaning that there was not enough demand to sell all of the securities that holders desired to sell at auction. The immediate effect of a failed auction is that such holders cannot sell the securities at auction and the interest rate on the security generally resets to a maximum interest rate. In the case of funds invested by the Company in ARS which are the subject of a failed auction, the Company may not be able to access the funds without a loss of principal, unless a future auction of these investments is successful or the issuer redeems the security. As of June 30, 2008, the Company has classified its ARS investment balance as long term investments because of the Company s belief that it could take more than one year before they are readily marketable. The Company has also modified its current investment strategy and increased its investments in more liquid money market funds.

At June 30, 2008, observable market information was not available to determine the fair value of the Company s ARS investments. Therefore, the Company estimated their fair values using valuation models that relied on Level 3 inputs including those that are based on expected cash flow streams and collateral values, assessments of counterparty credit quality, default risk underlying the security, market discount rates and overall capital market liquidity. The valuation of the Company s ARS investment portfolio is subject to uncertainties that are difficult to predict. Factors that may impact the Company s valuation in the future include changes to credit ratings of the securities, as well as to the underlying assets supporting those securities, rates of default of the underlying assets, underlying collateral value, discount rates, counterparty risk and ongoing strength and quality of market credit and liquidity. These financial instruments are classified within Level 3 of the fair value hierarchy.

As of June 30, 2008, financial assets measured and recognized at fair value on a recurring basis and classified under the appropriate level of the fair value hierarchy as described above was as follows (in thousands):

	Level 1	Level 2	Level 3	Total
Cash equivalents	$ 20,464	$	$	$ 20,464
Short term marketable investments:				
Available-for-sale securities		75,872		75,872
Long term investments:				
Available for sale ARS			11,478	11,478
Total assets at fair value	$ 20,464	$ 75,872	$ 11,478	$ 107,814