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BRITESMILE INC
Form 10-Q
November 02, 2001

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

FORM 10-Q

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

For the Quarterly Period Ended: September 29, 2001

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: 1-11064

BRITESMILE, INC.

(Exact name of business issuer as specified in its charter)

UTAH

87-0410364

(State or other jurisdiction of
incorporation or organization)

(IRS employer identification no.)

490 North Wiget Lane
Walnut Creek, California

94598

(Address of principal executive offices)

(Zip Code)

(925) 941-6260

(Issuer's telephone number, including area code)

(Former name, former address and former fiscal year,
if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section
13 or 15(d) of the Securities Exchange Act during the past 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.

X yes no
--- -----

The Company had 36,196,961 shares of common stock outstanding at October 12,
2001.

BRITESMILE, INC. AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BRITESMILE, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 ASSETS
 (\$ in thousands, except share data)

	September 29, 2001
	(Unaudited)
CURRENT ASSETS:	
Cash and cash equivalents.....	\$ 14,009
Cash, restricted as to use.....	843
Trade accounts receivable, net of allowance for doubtful accounts of \$616 and \$163, respectively.....	6,368
Inventories.....	2,583
Prepaid expenses and other.....	1,154
Notes receivable-current portion.....	335
Total current assets.....	25,292
PROPERTY AND EQUIPMENT, net.....	21,302
NOTE RECEIVABLE, less current portion.....	140
OTHER ASSETS.....	2,049
TOTAL ASSETS.....	\$ 48,783

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The accompanying notes to condensed consolidated financial statements are an integral part of these condensed consolidated balance sheets.

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BRITESMILE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (continued)
LIABILITIES AND SHAREHOLDERS' EQUITY
(\$ in thousands, except share data)

	September 29, 2001
	(Unaudited)
CURRENT LIABILITIES:	
Accounts payable.....	\$ 6,148
Accrued expenses	2,434
Note payable, net of discount.....	150
Accrual for store closures.....	439
Capital lease obligation-current portion.....	447

Total current liabilities.....	9,618

Note payable.....	1,990
Subordinated convertible debenture, net of discount.....	724
Capital lease obligations, less current portion.....	2,933
Other long-term liabilities.....	476

Total long-term liabilities.....	6,123

Total liabilities.....	15,741

SHAREHOLDERS' EQUITY:	
Common stock, \$.001 par value; 50,000,000 shares authorized; 36,196,961 and 28,816,515 shares issued and outstanding, respectively	36
Additional paid-in capital.....	136,366
Accumulated deficit.....	(103,360)

Total shareholders' equity	33,042

Total liabilities and shareholders' equity.....	\$ 48,783
	=====

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The accompanying notes to condensed consolidated financial statements are an integral part of these condensed consolidated balance sheets.

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BRITESMILE, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 Unaudited
 (\$ in thousands except share data)

	13 Weeks Ended September 29, 2001	13 Weeks Ended September 30, 2000	39 Wee Septe 2
REVENUES:			
Center whitening fees, net.....	\$ 3,182	\$ 3,253	\$
Associated Center whitening fees, net.....	8,010	1,515	
Product sales.....	1,509	411	
	-----	-----	
Total revenues, net.....	12,701	5,179	
	-----	-----	
OPERATING COSTS AND EXPENSES:			
Operating and occupancy costs.....	4,376	3,574	
Selling, general and administrative expenses.	11,675	9,550	
Research and development expenses.....	334	557	
Depreciation and amortization.....	1,059	1,243	
	-----	-----	
Total operating costs and expenses.....	17,444	14,924	
	-----	-----	
Loss from operations.....	(4,743)	(9,745)	
	-----	-----	
OTHER INCOME (EXPENSE), net:			

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Interest expense.....	(186)	(388)
Interest income.....	139	80
	-----	-----
Total other income (expense), net.....	(47)	(308)
	-----	-----
Loss before income tax provision.....	(4,790)	(10,053)
INCOME TAX PROVISION.....	-	-
	-----	-----
Net loss	\$ (4,790)	\$ (10,053)
	=====	=====
BASIC AND DILUTED NET LOSS PER SHARE.....	\$ (0.13)	\$ (0.42)
	=====	=====
WEIGHTED AVERAGE SHARES - BASIC AND DILUTED.....	35,873,103	23,920,694
	=====	=====

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

BRITESMILE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
Unaudited
(\$ in thousands, except share data)

		39 Weeks Ended September 29, 20

CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss.....	\$	(14
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization		3
Cost for issuance of stock and stock options.....		
Changes in assets and liabilities.....		(7

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Net cash used in operating activities.....		(17)
<hr style="border-top: 1px dashed black;"/>		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from assets held for sale, net.....		(7)
Purchase of property and equipment.....		(7)
<hr style="border-top: 1px dashed black;"/>		
Net cash used in investing activities.....		(7)
<hr style="border-top: 1px dashed black;"/>		
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on borrowing.....		2
Payments on line of credit.....		26
Proceeds from debt financing		4
Proceeds from common stock offering.....		4
Proceeds from exercise of stock options		4
<hr style="border-top: 1px dashed black;"/>		
Net cash provided by financing activities.....		33
<hr style="border-top: 1px dashed black;"/>		
NET INCREASE IN CASH AND CASH EQUIVALENTS.....		8
<hr style="border-top: 1px dashed black;"/>		
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD.....		5
<hr style="border-top: 1px dashed black;"/>		
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD.....	\$	14
<hr style="border-top: 3px double black;"/>		
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest.....	\$	
<hr style="border-top: 3px double black;"/>		
Cash paid for income taxes.....	\$	
<hr style="border-top: 3px double black;"/>		
Equipment acquired under capital lease.....	\$	2
<hr style="border-top: 3px double black;"/>		
Options granted for consulting services.....	\$	
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The accompanying notes to condensed consolidated financial statements are an integral part of these condensed consolidated statements of cash flows.

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BRITESMILE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

September 29, 2001

1. Description of Business and Nature of Operations

BriteSmile, Inc., a Utah corporation (the "Company" or "BriteSmile"), and its affiliates develop, produce, license and sell advanced teeth whitening products, services and technology. Unless specified to the contrary herein, references to BriteSmile refer to the Company and its subsidiaries on a consolidated basis. The Company's operations include the development of technologically advanced teeth whitening processes that are distributed in professional salon settings known as BriteSmile Professional Teeth Whitening Centers ("Centers"). The Company also offers its products and technologies through arrangements with existing independent dental offices known as BriteSmile Professional Teeth Whitening Associated Centers ("Associated Centers").

BriteSmile offers consumers a new, simple and safe way to return their teeth to their optimal natural whiteness in a one and one-half hour visit to a Center or Associated Center.

Centers are located in major metropolitan areas nationwide and offer clients a salon-like environment dedicated solely to the business of teeth whitening. Centers are staffed by licensed dentists and trained dental assistants. Alternatively, consumers can visit an Associated Center, where a local dentist administers the BriteSmile procedure in the dentist's established office.

The Company developed its current teeth whitening technology (the "BriteSmile Light Activated Teeth Whitening System," "BS2000" or "LATW") and began distribution in 1999. In November 1999 the Company introduced its new BriteSmile 3000 LATW keycard system (the "BS3000") to Associated Centers. The BS3000, a mobile version of the BS2000, can be installed quickly and provides improved flexibility and mobility in dental offices. In May 2001, the Company introduced its more versatile mobile device, the BS3000PB, which is the device currently shipped to Associated Centers.

The BS2000, BS3000, and BS3000PB teeth whitening devices utilize a light technology. The unique delivery arm of these devices permits blue green light to reach all 16 front teeth simultaneously, whitening the teeth by activating BriteSmile's wavelength-specific gel during three consecutive twenty-minute sessions.

In February 1999, the LATW was introduced in the Company's first Center in Walnut Creek, California. In March 1999, the Company opened its first Associated Center in Louisville, Kentucky. As of September 29, 2001, the Company had 14 Centers and 3,241 Associated Centers in operation.

The Company is not engaged in the practice of dentistry. Each licensed dentist who operates a Center or Associated Center maintains full control over dental matters, including the supervision of dental auxiliaries and the administration of the LATW procedure.

The Company operates in one reportable segment. The Company's chief operating decision maker has determined the operating segment based upon how the business is managed and operated. Geographical segments are not material as of September 29, 2001.

Basis of Presentation

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The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions in Form 10-Q and Article 10 of Regulations S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

Operating results for the 13 weeks and 39 weeks ended September 29, 2001 are not necessarily indicative of the results that may be expected for the remainder of the fiscal year ending December 29, 2001. The balance sheet at December 30, 2000 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles

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BRITESMILE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

generally accepted in the United States for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the Nine-Month Transition Period ended December 30, 2000.

2. Loss Per Common Share

The Company computes loss per common share in accordance with Statement of Financial Accounting Standards No. 128, "Earnings Per Share." In accordance with FAS 128, basic net loss per share is calculated as net loss divided by the weighted-average number of common shares outstanding, less shares subject to repurchase. Diluted net loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding and dilutive common stock equivalents outstanding during the period. Common equivalent shares from stock options and warrants (using the treasury stock method) and convertible notes payable have been excluded from the calculation of net loss per share as their effect is anti-dilutive.

3. Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. Inventories consist primarily of dental supplies, retail products and component parts for the manufacturing of teeth whitening systems.

4. Reclassifications

Certain reclassifications have been made in the prior period's condensed consolidated financial statements to conform with the current period presentation.

5. Bank Line of Credit

The Company's revolving credit line agreement with the Bank of Hawaii expired on May 25, 2001. The Company is currently in the process of negotiating a new line of credit.

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6. Long Term Debt

As of September 29, 2001, \$800,000 of an original aggregate of \$20 million of convertible promissory notes first issued in August 2000 remain outstanding, at an adjusted conversion price of \$5.00 per share.

On December 5, 2000, the Company sold to LCO Investments Limited ("LCO") in a private placement a Convertible Promissory Note (the "December 2000 Note") in the aggregate principal amount of \$5,000,000. LCO is the Company's largest shareholder. The December 2000 Note was convertible into shares of Common Stock of the Company at a conversion price of \$5.00 per share. In conjunction with the issuance of the December 2000 Note, warrants to purchase 250,000 shares of Common Stock were issued at an exercise price of \$5.00 per share. The warrants have a contractual life of 5 years. The fair value of the warrants issued of \$253,000 was recorded as a discount of the December 2000 Note and was being amortized over the life of the note to interest expense. At September 29, 2001 the warrants remain outstanding. Interest accrued at the annual rate of 7.52% and was due and payable along with the principal balance on December 5, 2001. On April 10, 2001, LCO elected to convert the December 2000 Note, together with accrued interest totaling \$132,644, into 1,026,529 shares of restricted common stock. As a result of the conversion, the remaining discount of \$253,000 was recognized as interest expense on the date of the conversion.

On March 1, 2001, the Company borrowed \$2,500,000 from Excimer Vision Leasing L.P. ("EVL") for general working capital. The loan matures on May 10, 2006 and is not prepayable. Payments under the loan consist of "fixed payments" of interest, "variable payments" of principal and a "final payment" of principal. An initial fixed payment of \$10,416.60 was paid on April 1, 2001. Additional monthly payments of \$12,500 are due during the loan period. Variable payments are twenty-five dollars for each LATW procedure performed at the Company's 14

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current Centers. For the thirty-nine weeks ended September 29, 2001 variable payments totaled \$490,000. The final payment, due at maturity, will be the amount by which the aggregate of variable payments paid during the term of the loan is less than the original \$2.5 million principal amount of the loan.

7. Private Placement

On April 30, 2001, the Company completed a private offering (the "Offering") of its restricted common stock, par value \$0.001 per share. The Offering involved sales of a total of 5,371,428 shares of restricted common stock (the "Shares") to 17 accredited investors and their affiliated funds (the "Investors"). None of the Investors were affiliated with the Company before the completion of the Offering. The Company sold the Shares for \$5.25 per share, yielding gross proceeds to the Company of \$28,199,997.

In connection with the Offering, the Company engaged Stonegate Securities, Inc., of Dallas, Texas (the "Placement Agent") to act as placement agent for the Offering. For its services, the Company agreed to pay the Placement Agent five percent of the gross proceeds of the Offering, or \$1,410,000, and issue to the Placement Agent warrants to purchase a total of 537,143 shares of restricted common stock for a per share purchase price of \$5.25. The warrants have a five year term. The fees paid to the Placement Agent and the fair value of the warrants of \$704,000 were netted against the Offering proceeds.

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In connection with the Offering, the Company filed with the Securities and Exchange Commission (the "SEC") a registration statement covering the Shares and the common stock underlying the warrants issued to the Placement Agent. The SEC declared the registration statement effective on June 11, 2001.

PART II - OTHER INFORMATION

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Such forward-looking statements may be deemed to include information that is not historical. The statements contained in this Report that are not purely historical are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act. These statements relate to the Company's expectations, hopes, beliefs, anticipations, commitments, intentions and strategies regarding the future. They may be identified by the use of words or phrases such as "believes," "expects," "anticipates," "should," "plans," "estimates," and "potential," among others. Forward-looking statements include, but are not limited to, statements contained in Management's Discussion and Analysis of Financial Condition and Results of Operations regarding the Company's financial performance, revenue and expense levels in the future and the sufficiency of its existing assets to fund future operations and capital spending needs. Actual results could differ materially from the anticipated results or other expectations expressed in such forward-looking statements. The Company believes that many of the risks set forth here and in the Company's 10-K Annual Reports filed with the SEC are part of doing business in the industry in which the Company operates and competes and will likely be present in all periods reported. The forward-looking statements contained in this Report are made as of the date of this Report and the Company assumes no obligation to update them or to update the reasons why actual results could differ from those projected in such forward-looking statements. Among others, risks and uncertainties that may affect the business, financial condition, performance, development, and results of operations of the Company include:

- o Government regulation of the Company's products and teeth whitening procedures, including: (i) current restrictions or controls on the practice of dentistry by general business corporations, and (ii) future, unknown enactments or interpretations of current regulations which could, in the future, affect the Company's operational structure and relationships with licensed dentists;
- o Failure of the Company to generate, sustain or manage growth, including failure to develop new products and expand Associated Center locations and revenues;
- o The loss of product market share to competitors and/or development of new or superior technologies by competitors;
- o Ongoing operating losses associated with the development, marketing and implementation of new, light-activated teeth whitening technologies;
- o Failure of the Company to secure additional financing to complete its

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aggressive plan for the rollout of a broad base of Associated Centers;

- o Unproven market for the Company's new whitening products, whitening process, and "Whitening Center" and "Associated Center" concepts, in light of competition from traditional take-home whitening products and bleaching tray methods;
- o Failure to develop marketing strategies and delivery methods to penetrate non-U.S. markets; and
- o Lack of product diversity.

Overview

Operating and occupancy costs is composed primarily of three main groups: 1) the cost of goods for both the Center and Associated Center whitening procedure kits and retail products; 2) the financing costs for the devices in the Associated Centers; and 3) the operating and occupancy costs for the Company Centers.

Selling, general and administrative expenses are composed of expenses associated with all corporate and administrative functions that support existing operations and provide an infrastructure to support future growth, including management and staff salaries, employee benefits, travel, information systems, operating costs of the Call Center, training, field support and marketing and advertising. Expenses of recruiting and training sales, market support and training staff are also included as general and administrative expenses.

The following discussion should be read in conjunction with the Financial Statements and the Notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q and in the Company's Annual Report on Form 10-K for the transition period ended December 30, 2000.

As of September 29, 2001, the Company has 14 BriteSmile Centers. The following table sets forth certain information relating to the status of the Associated Centers as of September 29, 2001:

Associated Centers
Roll-out Status
As of September 29, 2001

Associated Centers	AC's	Int'l	Grand Total
Total Under Contract (1)	3,304	459	3,763
Active - In Business	2,760	459	3,219

(1) Represents all Associated Centers in operation, plus Associated Centers for which a contract has been received but where the dentist who will operate the Associated Center is either awaiting training or shipment of the BS3000 PB device.

The following table sets forth unaudited operating results for the thirteen week period and thirty-nine week period ended September 29, 2001 and September 30,

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2000, as a percentage of sales in each of these periods. This data has been derived from the unaudited financial statements.

	Thirteen Weeks ended	Thirteen Weeks ended	Thirty-Nine Weeks ended	Thirty-Nine Weeks ended
	Sept. 29, 2001	Sept.30, 2000	Sept.29, 2001	Sept.30, 2000
	-----	-----	-----	-----
Income Statement Data:				
Revenues:				
Center whitening fees, net	25.0%	62.8%	32.7%	58.7%
Associated Center whitening fees, net	63.1%	29.3%	56.9%	35.3%

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Product sales	11.9%	7.9%	10.4%	6.0%
	-----	-----	-----	-----
Total revenues, net	100.0%	100.0%	100.0%	100.0%
	-----	-----	-----	-----
Operating Costs and Expenses:				
Operating and occupancy costs	34.5%	69.0%	35.8%	137.9%
Selling, general and administrative expenses	91.9%	184.4%	90.2%	125.8%
Research and development expenses	2.6%	10.8%	2.7%	10.9%
Depreciation and amortization	8.3%	24.0%	9.9%	22.6%
	-----	-----	-----	-----
Total operating costs and expenses	137.3%	288.2%	138.6%	297.2%
	-----	-----	-----	-----
Loss from operations	-37.3%	-188.2%	-38.6%	-197.2%
	-----	-----	-----	-----
Interest income (expense), net	-0.4%	-5.9%	-1.7%	-0.1%
	-----	-----	-----	-----
Loss before income tax provision	-37.7%	-194.1%	-40.3%	-197.3%
Provision for income taxes	0.0%	0.0%	0.2%	0.3%
	-----	-----	-----	-----
Net Loss	-37.7%	-194.1%	-40.5%	-197.6%
	=====	=====	=====	=====

The following are explanations of significant period-to-period changes for the 13 weeks ended September 29, 2001 and September 30, 2000:

Revenues

Total Revenues, net. Total revenues, net increased by \$7.5 million, or 145.2%,

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to \$12.7 million for the 13 weeks ended September 29, 2001, from \$5.2 million for the 13 weeks ended September 30, 2000.

Center Whitening Fees, net. Center whitening fees, net decreased slightly by \$70,000, or 2.0%, to \$3.2 million for the 13 weeks ended September 29, 2001, from \$3.2 million for the 13 weeks ended September 30, 2000. This decrease was primarily due to the closure of three underperforming Centers in the first quarter of 2001 that were open in the third quarter of 2000. The number of procedures performed in the Centers decreased 6.3% to 7,116 procedures in the third quarter of 2001 compared to 7,591 procedures in the same quarter of 2000, primarily as a result of the closure of three Centers.

Associated Center Whitening Fees, net. Associated Center whitening fees, net increased by \$6.5 million, or 428.6%, to \$8.0 million for the 13 weeks ended September 29, 2001, from \$1.5 million for the 13 weeks ended September 30, 2000. This increase was primarily due to the operation of 3,219 Associated Centers at the end of the 13 weeks ended September 29, 2001 compared to 884 Associated Centers that were in operation at the end of the 13 weeks ended September 30, 2000. Of the 3,219 Associated Centers in operation at September 29, 2001, 459 were international locations. The number of procedures performed in the Associated Centers increased 348.2% to 37,040 procedures in the third quarter of 2001 compared to 8,265 procedures in the same quarter of 2000.

During the 13 weeks ended September 29, 2001, the Company opened 976 new Associated Centers. At September 29, 2001, there were Associated Centers in the process of being placed into operation. Due to training and shipping requirements, there is presently approximately 45 days of lead-time between the signing of an Associated Center agreement and the first paid procedures at that Associated Center.

Although the Company does not believe that its business follows seasonal trends, it has recognized that at various times during the months of July and August and again during December and January, a substantial number of Associated Center locations (both domestic and international) shut down their practices for vacation. As a result, the frequency of key card purchases by Associated Centers during these months declines as well.

The Company continues to execute its strategic plan of expanding distribution into the professional dental practice channel through its Associated Centers. Additionally, the Company anticipates opening additional Associated Centers in domestic and international locations over the next twelve months. As a result, Associated Center whitening fees are expected to increase during the next twelve months. There can be no guarantee that the Company will be successful in executing its business plan.

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Product Sales. Product sales increased by \$1.1 million, or 267.3% to \$1.5 million for the 13 weeks ended September 29, 2001 from \$411,000 for the 13 weeks ended September 30, 2000. Product sales represent the Company's toothpaste, mouthwash, whitening gum and the Sonicare toothbrush products sold at Centers and Associated Centers. Product sales are expected to increase during the next twelve months as a result of the introduction of additional oral care products to be sold at Centers, Associated Centers, and through the Company's E-Commerce website.

Operating Costs and Expenses

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Operating and Occupancy Costs. Operating and occupancy costs decreased as a percentage of revenues to 34.5% for the thirteen weeks ended September 29, 2001, compared to 69.0% in the thirteen weeks ended September 30, 2000. This decrease as a percentage of sales is a reflection of the lower fixed cost structure of the Associated Center sales channel.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased as a percentage of sales to 91.9% for the third quarter of 2001 compared to 184.4% in the corresponding period in 2000. This decrease was primarily due to improved leveraging of marketing and advertising expenditures across a greater number of Associated Center markets. The increase of \$2.1 million in total selling, general and administrative expenses to \$11.7 million for the third quarter of 2001 from \$9.6 million in the third quarter of 2000 was primarily attributable to increased expenses to support the Company's expansion, including: (i) salaries and benefits and (ii) sales, training, marketing and advertising activities. As a result of catching up on the backlog of new customers which required higher than originally expected field personnel costs, at the start of the fourth quarter of 2001 the Company has been able to streamline its field personnel which will result in lower costs in the future, as well as reductions in corporate overhead expenses.

During the weeks following the September 11, 2001 terrorist attacks, the Company saw an immediate drop in revenue, with the New York area being hardest hit within the BriteSmile network of Associated Centers and the Company's own Center in New York. As a result, the Company assessed the variables in the business that could be controlled and immediately responded to the volatility in sales. The Company took steps to reduce overall expenses by \$6.5 million (annualized) against the August/September 2001 run rate.

Research and Development Expenses. Research and development expenses decreased as a percentage of sales to 2.6% for the third quarter of 2001 compared to 10.8% in the corresponding period in 2000. The \$334,000 expense incurred in the third quarter of 2001 was primarily related to research studies to expand the Company's leadership position in the teeth-whitening industry.

Depreciation and Amortization. Depreciation and amortization decreased as a percentage of sales to 8.3% for the third quarter of 2001 compared to 24.0% in the corresponding period in 2000. This percentage decrease is primarily due to the increase in both Center and Associated Center sales. The decrease of \$184,000 in depreciation and amortization expense to \$1.1 million for the third quarter of 2001 is the result of lower depreciation due to the closing of three Centers, offset by a greater number of BS3000 and BS3000PB systems in the Associated Centers.

Interest Expense, net. Interest expense, net decreased to \$47,000 for the third quarter of 2001 compared to interest expense, net of \$308,000 in the corresponding quarter of 2000. Interest expense decreased as a result of less debt outstanding in the third quarter of 2001 versus the same quarter of 2000.

Net Loss. The net loss decreased \$5.3 million to \$4.8 million for the third quarter of 2001 compared to a net loss of \$10.1 million in the corresponding quarter of 2000. This represents a 52.4% improvement due to a combination of the factors described above. Net loss per share for the third quarter of 2001 was (\$0.13) versus (\$0.42) reported for the third quarter of 2000, which represents a 69.0% improvement over the third quarter of 2000.

The following are explanations of significant period-to-period changes for the 39 weeks ended September 29, 2001 and September 30, 2000:

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Revenues

Total Revenues, net. Total revenues, net increased by \$21.8 million, or 168.1%, to \$34.8 million for the 39 weeks ended September 29, 2001, from \$13.0 million for the 39 weeks ended September 30, 2000.

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Center Whitening Fees, net. Center whitening fees, net increased by \$4.0 million, or 52.9%, to \$11.4 million for the 39 weeks ended September 29, 2001, from \$7.4 million for the 39 weeks ended September 30, 2000. This increase was primarily due to a 31.2% increase in comparable Center sales for the first three quarters of 2001.

Associated Center Whitening Fees, net. Associated Center whitening fees, net increased by \$15.2 million, or 332.1%, to \$19.8 million for the 39 weeks ended September 29, 2001, from \$4.6 million for the 39 weeks ended September 30, 2000. This increase was primarily due to the operation of 3,219 Associated Centers at the end of the 39 weeks ended September 29, 2001 compared to 884 Associated Centers that were in operation at the end of the 39 weeks ended September 30, 2000. Of the 3,219 Associated Centers in operation at September 29, 2001, 459 were international locations. The number of procedures performed in the Associated Centers increased 266.4% to 88,860 procedures during the thirty-nine weeks ended September 30, 2001 compared to 24,249 procedures during the thirty-nine weeks ended September 30, 2000.

Although the Company does not believe that its business follows seasonal trends, it has recognized that at various times during the months of July and August and again during December and January, a substantial number of Associated Center locations (both domestic and international) shut down their practices for vacation. As a result, the frequency of key card purchases by Associated Centers during these months declines as well.

Product Sales. Product sales increased by \$2.8 million, or 362.2% to \$3.6 million for the 39 weeks ended September 29, 2001 from \$779,000 for the 39 weeks ended September 30, 2000. Product sales represent the Company's toothpaste, mouthwash, whitening gum and Sonicare toothbrush products sold at Centers and Associated Centers. Product sales are expected to increase during the next twelve months as a result of the introduction of additional oral care products to be sold at Centers, Associated Centers, and through the Company's E-Commerce website.

Operating Costs and Expenses

Operating and Occupancy Costs. Operating and occupancy costs decreased as a percentage of revenues to 35.8% for the 39 weeks ended September 29, 2001 compared to 137.9% for the 39 weeks ended September 30, 2000. Similar to the second quarter of 2001, this decrease as a percentage of sales is a reflection of the significant increase in both Center and Associated Center sales combined with decreases in product costs as a percentage of sales as a result of improved purchasing along with the lower fixed cost structure of the Associated Center sales channel. Additionally, operating costs includes \$2.0 million of lease financing expenses for the 39 weeks ended September 29, 2001 versus zero lease financing expenses in the same period of 2000.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased as a percentage of sales to 90.2% for the 39

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weeks ended September 29, 2001 compared to 125.8% for the 39 weeks ended September 30, 2000. This decrease was primarily due to improved leveraging of marketing and advertising expenditures across a greater number of Associated Center markets. The increase of \$5.8 million in total selling, general and administrative expenses to \$31.3 million for the thirty-nine weeks ended September 29, 2001 from \$25.5 million in the twenty-six weeks ended July 1, 2000 was primarily attributable to the increase in the Company's infrastructure as it prepared for aggressive expansion of its number of Associated Centers. This included salaries and benefits, and marketing and advertising activities, to support the Company's expansion.

Research and Development Expenses. Research and development expenses decreased as a percentage of sales to 2.7% for the 39 weeks ended September 29, 2001 compared to 10.9% for the 39 weeks ended September 30, 2000. Actual dollars spent on research and development decreased \$491,000 between the two periods. For the first three quarters of 2001, the Company incurred expenses primarily related to 1) American Dental Association (ADA) comparative, safety, and efficacy studies, 2) studies performed by Loma Linda University for the young adult market and 3) other research studies to expand the Company's leadership position in the teeth-whitening industry.

Depreciation and Amortization. Depreciation and amortization decreased as a percentage of sales to 9.9% for the 39 weeks ended September 29, 2001 compared to 22.6% during the 39 weeks ended September 30, 2000. This percentage decrease is primarily due to the increase in both Center and Associated Center sales. The increase of \$502,000 in depreciation and amortization expense is primarily the result of a greater number of BS3000 and BS3000PB systems in the Associated Centers.

Interest Expense, net. Interest expense, net increased to \$578,000 for the 39 weeks ended September 29, 2001 compared to interest expense, net of \$45,000 in the 39 weeks ended September 30, 2000. Interest expense in 2001 primarily represents the acceleration of interest expense for the December 2000 Note in the amount of \$253,000, along with other debt incurred by the Company and the amortization of the fair market value of the warrants issued with that debt (see Note 5) and interest expense on the capital leases.

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Net Loss. The net loss decreased \$11.4 million to \$14.0 million for the 39 weeks ended September 29, 2001 compared to a net loss of \$25.4 million in the 39 weeks ended September 30, 2000. This represents a 44.9% improvement due to a combination of the factors described above. Net loss per share for the thirty-nine weeks ended September 29, 2001 was (\$0.43) versus (\$1.06) reported for the thirty-nine weeks ended September 30, 2000, which represents a 59.4% improvement.

Liquidity and Capital Resources

General

The Company's principal sources of liquidity have been issuances of convertible debt, common stock and common stock equivalents. At September 29, 2001, the Company had \$14.0 million of cash and cash equivalents. The Company expects to sign contracts for additional Associated Centers during the next twelve months. This expansion is contingent upon several factors, including available cash resources and acceptance by consumers and Associated Center dentists of the Company's LATW services. The Company expects that operating losses will continue

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through the fiscal year ending December 29, 2001, and that its principal uses of cash will be to provide working capital, to finance capital expenditures, and to satisfy other general corporate expenses. In particular, the Company plans to use its cash to finance its marketing strategy and the continued rollout of Associated Centers.

Cash flow used in operations was reduced by \$9.8 million to \$17.7 million for the 39 weeks ended September 29, 2001 from \$27.5 million used in operating activities during the 39 weeks ended September 30, 2000, primarily due to the decrease in the net loss recognized and the net effect of timing differences in the collection and disbursement of working capital components.

Net cash provided by financing activities was \$33.5 million for the thirty-nine weeks ended September 29, 2001, as compared to \$39.6 million for the same period in 2000. In March 2001, the Company engaged the services of Stonegate Securities, Inc. to assist the Company in raising capital through a private placement. On April 30, 2001, the Company completed a private placement of its common stock in the aggregate amount of \$28.2 million to 17 investors and their affiliated funds. The offering consisted of the sale of 5,371,428 shares of the Company's restricted common stock at an offering price of \$5.25 per share, resulting in gross proceeds to the Company of \$28,199,997. In addition, the Company received \$4.6 million in cash from the issuance of common stock upon the exercise of stock options during the first nine months of 2001 compared to \$1.5 million received from the issuance of common stock upon the exercise of stock options during the same period in 2000.

Capital expenditures were \$7.5 million for the thirty-nine weeks ended September 29, 2001, compared to \$10.8 million for the same period in 2000. The capital expenditures in the first three quarters of 2001 were primarily related to the development and purchase of BS3000 and BS3000PB systems for the international Associated Centers, expansion of the Company's call center, and final payments for the build-out of the New York Center. New devices were also funded through the use of \$2.4 million from the EVL lease line.

While management believes that the Company can continue its current operating strategy without additional funding, cash flows are difficult to forecast accurately. Therefore, there can be no assurance that additional capital will not be required, or that it will be available on terms that are acceptable to the Company. Additionally, there can be no assurance that the Company's business will generate cash flows at or above current levels. Accordingly, the Company may choose to defer capital expenditure plans.

Inflation

Most of the Company's products are purchased in finished form and packaged by the supplier or at the Company's headquarters. The Company anticipates usual inflationary increases in the price of its products and does not intend to pass these increases along to its customers, primarily as a result of other operating efficiencies gained through changing the sourcing of certain of its products. In general, the Company does not believe that inflation has had a material effect on its results of operations in recent years. However, there can be no assurance that the Company's business will not be affected by inflation in the future.

Seasonality

Although the Company does not believe that its business follows seasonal trends, it has recognized that at various times during the months of July and August and again during December and January, a substantial number of Associated Center locations (both domestic and international) shut down their practices for vacation. As a result, the frequency of key card purchases by Associated Centers

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during these months declines as well. Additionally, the Company's Centers have recognized some seasonality during the same months because of customer vacations.

PART II - OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES.

Option Grants

During the period of July 1, 2001 to September 29, 2001, the Company granted non-qualified stock options to key employees under its 1997 Stock Option and Incentive Plan covering an aggregate of 96,000 shares of the Company's common stock, at exercise prices ranging from \$5.55 to \$14.00 per share. The options vest over a period of time following their respective dates of grant. The Company claimed exemption from registration under the Securities Act of 1933 (the "Securities Act") for these grants in that the Company believes such grants were not "sales" within the meaning of the Securities Act.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(A) EXHIBITS

None filed with this report.

(B) REPORTS ON FORM 8-K

No Reports on Form 8-K were filed during the period for which this report is filed.

SIGNATURES

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

BRITESMILE, INC.

/s/ John L. Reed

November 2, 2001

John L. Reed
Chief Executive Officer

Date

/s/ Peter P. Hausback

November 2, 2001

Peter P. Hausback
Chief Financial Officer

Date