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BRITESMILE INC
Form 10-Q
November 09, 2004

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

FORM 10-Q

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

For the Quarterly Period Ended: September 25, 2004

or

Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the Transition Period from _____ to _____

Commission File Number: 1-11064

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

UTAH 87-0410364

(State or other jurisdiction of incorporation (IRS employer identification no.)
or organization)

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)

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

Yes No

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

Yes No

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The Company had 10,340,920 shares of common stock outstanding at November 4, 2004.

During the fourth quarter of 2003, the Board of Directors approved a 5 for 2 stock split, which took effect January 30, 2004. All shares and per share amounts herein have been adjusted for the 5 for 2 stock split.

BRITESMILE, INC. AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BRITESMILE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS (unaudited)
(\$ in thousands, except share data)

| | September 25, 2004 |
|---|--------------------|
| CURRENT ASSETS: | |
| Cash and cash equivalents..... | \$ 8,274 |
| Trade accounts receivable, net of allowances of \$391 and \$467.... | 2,342 |
| Inventories..... | 2,028 |
| Prepaid expenses and other..... | 456 |
| | ----- |
| Total current assets..... | 13,100 |
| | ----- |
| PROPERTY AND EQUIPMENT, net..... | 13,352 |
| OTHER ASSETS..... | 3,925 |
| INTANGIBLES, net..... | 5,631 |
| | ----- |
| TOTAL ASSETS..... | \$ 36,008 |
| | ===== |

See notes to condensed consolidated financial statements.

BRITESMILE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (continued)

LIABILITIES AND SHAREHOLDERS' EQUITY
(unaudited)
(\$ in thousands, except share data)

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September 25, 2004

CURRENT LIABILITIES:

| | | |
|---|----|-------|
| Accounts payable..... | \$ | 4,430 |
| Accrued expenses | | 5,556 |
| Gift certificate and prepaid appointments..... | | 562 |
| Deferred revenue | | 740 |
| Accrual for Center closure..... | | 267 |
| Current portion of long-term debt..... | | 329 |
| Capital lease obligations with related parties - current portion. | | 1,388 |

Total current liabilities..... 13,272

LONG TERM LIABILITIES:

| | | |
|---|--|-------|
| Capital lease obligations with related parties - less current portion | | 441 |
| Accrual for Center closure..... | | 608 |
| Long-term debt, less current portion..... | | 5,123 |
| Other long-term liabilities..... | | 827 |

Total long-term liabilities..... 6,999

Total liabilities..... 20,271

SHAREHOLDERS' EQUITY:

| | | |
|---|--|-----------|
| Common stock, \$.001 par value; 50,000,000 shares authorized; 10,332,899 and 9,525,265 shares issued and outstanding, respectively | | 38 |
| Additional paid-in capital..... | | 170,413 |
| Accumulated deficit..... | | (154,714) |

Total shareholders' equity 15,737

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY..... \$ 36,008

See notes to condensed consolidated financial statements.

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

13 Weeks Ended

13 Weeks Ended

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| | September 25, 2004 | September 27, 2003 | Sep |
|---|-----------------------|-----------------------|-------|
| REVENUES: | | | |
| Center whitening fees, net..... | \$ 4,346 | \$ 4,616 | \$ |
| Associated Center whitening fees, net..... | 5,646 | 5,387 | |
| Product sales..... | 1,884 | 1,434 | |
| | ----- | ----- | ----- |
| Total revenues, net..... | 11,876 | 11,437 | |
| | ----- | ----- | ----- |
| OPERATING COSTS AND EXPENSES: | | | |
| Operating and occupancy costs..... | 4,491 | 5,013 | |
| Selling, general and administrative expenses..... | 7,845 | 8,779 | |
| Research and development expenses..... | 110 | 403 | |
| Depreciation and amortization..... | 1,692 | 1,688 | |
| | ----- | ----- | ----- |
| Total operating costs and expenses..... | 14,138 | 15,883 | |
| | ----- | ----- | ----- |
| Loss from operations..... | (2,262) | (4,446) | |
| | ----- | ----- | ----- |
| OTHER INCOME (EXPENSE), net..... | (214) | (331) | |
| | ----- | ----- | ----- |
| Loss before income tax provision..... | (2,476) | (4,777) | |
| INCOME TAX..... | 32 | --- | |
| | ----- | ----- | ----- |
| Net loss | \$ (2,508) | \$ (4,777) | \$ |
| | ===== | ===== | ===== |
| BASIC AND DILUTED NET LOSS PER SHARE..... | \$ (0.24) | \$ (0.70) | \$ |
| | ===== | ===== | ===== |
| WEIGHTED AVERAGE SHARES - BASIC AND DILUTED..... | 10,329,190 | 6,796,368 | |
| | ===== | ===== | ===== |

See notes to condensed consolidated financial statements.

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

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September 25,

CASH FLOWS FROM OPERATING ACTIVITIES:

| | | |
|---|----|-------|
| Net loss..... | \$ | (4,47 |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization..... | | 5,82 |
| Increase in variable deferred payments to a related party.... | | 1,73 |
| Expense paid for by related party..... | | 74 |
| Loss on disposal of assets..... | | |
| Change in assets and liabilities, net..... | | (3,41 |
| | | ----- |
| Net cash provided by (used in) operating activities.. | | 41 |

CASH FLOWS FROM INVESTING ACTIVITIES

| | | |
|--|--|-------|
| Purchase of property and equipment..... | | (1,01 |
| Purchase of intangibles..... | | |
| | | ----- |
| Net cash used in investing activities..... | | (1,01 |

CASH FLOWS FROM FINANCING ACTIVITIES:

| | | |
|--|--|-------|
| Proceeds from debt financing..... | | |
| Payments on capital lease | | (6 |
| Payments on debt | | (3,68 |
| Proceeds from common stock offerings, net..... | | 6,33 |
| Proceeds from issuance of preferred stock by subsidiary..... | | |
| Proceeds from exercise of stock options | | 38 |
| | | ----- |
| Net cash provided by financing activities..... | | 2,98 |

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS 2,39

CASH AND CASH EQUIVALENTS AT BEGINNING
OF THE PERIOD..... 5,88

CASH AND CASH EQUIVALENTS AT END OF THE PERIOD..... \$ 8,27

See notes to condensed consolidated financial statements.

BRITESMILE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

September 25, 2004

1. Description of Business and Basis of Presentation

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BriteSmile, Inc., a Utah corporation ("BriteSmile" or the "Company"), and its affiliates develop, distribute, market, sell and lease advanced teeth whitening technology, products, systems and services. Unless specified to the contrary herein, references to BriteSmile or to the Company 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"). As of September 25, 2004, the Company had 14 Centers and 5,099 Associated Centers in operation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America 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 annual 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 and 39 weeks ended September 25, 2004 are not necessarily indicative of the results that may be expected for the remainder of the fiscal year ending December 25, 2004.

2. Stock Based Compensation

The Company uses the intrinsic value method to account for its stock based compensation plans. The alternative fair value accounting of the Company's options was estimated at the date of grant using a Black-Scholes option pricing valuation model with the following weighted-average assumptions: volatility of .7268, .6875, .8509, and .9769 for the 13 and 39 week periods ended September 25, 2004, and September 27, 2003, respectively; a risk-free interest rate range of 1.30% to 4.50% for the 13 and 39 week periods ended September 25, 2004, and September 27, 2003; dividend yield of 0%; and a weighted-average expected life of the option of 10 years. Had compensation cost for the Company's stock-based compensation plans been determined using the Black-Scholes option pricing valuation model, the Company's reported net loss applicable to common shareholders and basic and diluted net loss per share would have been increased to the pro forma amounts indicated below (in thousands, except per share data):

| | 13 Weeks Ended September 25, 2004 | 13 Weeks Ended September 27, 2003 | 39 Weeks Ended September 25, 2004 |
|--|---|---|---|
| | ----- | ----- | ----- |
| Loss as reported..... | \$ 2,508 | \$ 4,777 | \$ 4,477 |
| Compensation expense reported under APB25 | \$ - | \$ - | \$ 4 |
| Compensation expense computed using fair value method..... | \$ 712 | \$ 755 | \$ 2,377 |
| Pro forma loss..... | \$ 3,220 | \$ 5,532 | \$ 6,897 |
| Pro forma basic and diluted loss per share..... | \$ (0.31) | \$ (0.81) | \$ (0.66) |

BRITESMILE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

September 25, 2004

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 52 weeks ended December 27, 2003.

3. Loss Per Common Share

Basic net loss per share is calculated as net loss divided by the weighted-average number of common shares outstanding. Diluted net loss per share is equal to basic net loss as the Company has recorded a net loss. Stock options totaling 950,499 shares and warrants totaling 291,158 shares (using the treasury stock method) and convertible notes payable have been excluded from the calculation of net loss per share for the 13 and 39 week periods ending September 25, 2004, as their effect is anti-dilutive. Stock options totaling 793,008 shares and warrants totaling 341,163 shares (using the treasury stock method) and convertible notes payable have been excluded from the calculation of net loss per share for the 13 and 39 week periods ending September 27, 2003, as their effect is anti-dilutive.

4. Debt

During the third quarter of 2004, the Company paid off a loan with a remaining principal amount of \$0.8 million obtained in March 2001, to Excimer Vision Leasing L.P. ("EVL"), a related party.

In December 2003, the Company and EVL amended their capital lease agreement to provide that the variable rent portion of the monthly payment due beginning November 2003 and the fixed rent portion of the monthly payment due beginning January 2004 would be deferred and paid to EVL on February 15, 2005, with interest payable on the deferred amount at a rate equal to LIBOR, plus 250 basis points. In August 2004, the Company and EVL further amended their capital lease agreement to provide that the total rents deferred under the December 2003 lease amendment would be deferred further such that \$1.0 million would be paid on February 15, 2005, \$1.0 million would be paid on February 15, 2006, and the remaining balance due would be paid on February 15, 2007. As of September 25, 2004, the unpaid variable rent was \$2.1million, of which \$1.9 million is included in long-term debt.

5. Expense Paid By Related Party

During the quarter ending September 25, 2004, the Company incurred a \$0.75 million expense paid for by a principal stockholder/related party. The principal stockholder/related party engaged a consulting firm to conduct a study related to the Company. The cost of the study was paid for by the principal stockholder/related party, and was recorded by the Company as an expense and an increase to Additional Paid in Capital.

6. Legal Proceedings

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The Company is the subject of certain legal actions. Management does not believe that current pending litigation involving the Company will have a material adverse effect on the Company's consolidated financial position or results of operations. This conclusion has been developed in consultation with outside counsel handling BriteSmile's defense in the matters. However, the litigation and other claims noted in this report are subject to inherent uncertainties and it is possible that future results of operations for any particular quarterly or annual period could be materially affected by changes in management's assumptions and the effectiveness of BriteSmile's strategies related to these legal actions.

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BriteSmile, Inc. v. Discus Dental, Inc. and Salim Nathoo

This case was filed in the United States District Court for the Northern District of California (the "Discus Patent Litigation"). The Company filed an initial complaint against Discus Dental, Inc. ("Discus"), Culver City, California, in July 2002, asserting claims of infringement of the Company's U.S. Patents No. 6,343,933 and U.S. Patent No. 6,361,320. In February 2003, the Company amended the Discus Patent Litigation by adding Salim Nathoo ("Nathoo") as a defendant. The complaint, as amended, further alleges misappropriation of the Company's trade secrets, civil conspiracy, and unfair competition and business practices by Discus and Nathoo; breach of contract and breach of fiduciary duty by Mr. Nathoo, and tortuous interference with contract by Discus. The complaint alleges that Nathoo and Discus conspired to misappropriate BriteSmile's trade secrets in violation of Nathoo's contractual obligations to the Company. The amended lawsuit alleges that, as BriteSmile's Medical Director, Nathoo had, and continues to have, an obligation to keep BriteSmile's trade secrets confidential. Beginning in 2001, Discus Dental and Nathoo entered into an agreement whereby Discus Dental paid Nathoo at least \$2.5 million over a less than two year period for Nathoo's "consulting" services, which included paying Nathoo to share with Discus certain of the Company's trade secrets. The lawsuit alleges further that in December 2002, a third party informed BriteSmile of Nathoo's activities, and that when confronted by BriteSmile, Nathoo admitted to receiving \$2.5 million from Discus. The Company seeks a permanent injunction against both Discus and Nathoo to prevent further infringement of its patents and improper disclosure of the Company's trade secrets, lost profits, treble damages and attorneys fees for willful patent infringement, punitive damages, and other relief.

In March 2003, Discus filed its Answer to the Amended Complaint and Counterclaims. In its Answer, Discus denies any liability for BriteSmile's claims. Discus also raises affirmative defenses, including claims that its products and processes do not infringe BriteSmile's patents and that BriteSmile's patents are invalid and unenforceable. Discus asserts counterclaims against BriteSmile, seeking (i) judicial declarations that BriteSmile's patents are invalid, unenforceable, and have not been infringed, (ii) tortuous interference with prospective economic advantage and economic business relations, and (iii) unfair competition. Discus also asks for declarations that its products and processes do not violate BriteSmile's patents, that BriteSmile's patents are unenforceable, that BriteSmile has no protectable trade secrets, and that BriteSmile's contracts with Associated Center Dentists which contain contractual restrictions on the purchase and use of competitive systems are unenforceable and should be enjoined, and is seeking lost profits, treble damages and attorneys fees.

In July 2003, the Company filed the Second Amended Complaint, asserting

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additional clauses of infringement of the Company's US Patent No. 6,488,914, US Patent No. 6,514,543, and US Patent No. 6,536,628.

In July 2003, the case of Salim Nathoo v. BriteSmile Leasing (discussed below) was consolidated with the Discus Patent Litigation. All parties have produced documents and written discovery responses in support of their claims and defenses. Discovery is proceeding. The depositions of several key witnesses were taken from August through December 2003.

In April 2004, the Company filed a motion for leave to amend its complaint, which requested, among other things, dropping the Company's claims under its U.S. Patent Nos. 6,488,914 and 6,361,320. That motion was granted, and the Company has filed its Third Amended Complaint.

In April 2004, Nathoo filed an answer and counterclaim to the Company's complaint, as well as a third party complaint against Eric Montgomery, who is a director of the Company, and several of Montgomery's companies, alleging breach of contract, breach of covenant of good faith and fair dealing, trade secret misappropriation, patent infringement, and civil conspiracy. In August 2004, Nathoo filed an amended answer and counterclaims to the Company's complaint. In his new amended counterclaims, Nathoo brought claims for correction of inventorship of several of the Company's patents; infringement by the Company of those same patents; misappropriation of trade secrets by the Company and selected named Company employees or directors; conversion by the Company, and named Company employees or directors; constructive trust for the patents he claims have incorrect inventorship; fraud against and breach of contract by the Company and selected named Company employees and directors and CAP Advisors Limited; tortious interference with contract by the Company; a declaration that

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the Company has no protectable trade secrets; and unfair competition against the Company and selected named Company officers and directors. In October 2004, Nathoo filed another amended answer and counterclaims in which he dropped his allegations of patent infringement.

The Company is seeking compensatory and punitive damages against Discus and compensatory damages against Nathoo. The exact amount of damages sought by both defendants has not yet been determined.

Salim Nathoo v. BriteSmile Leasing

In March 2003, Nathoo filed a lawsuit against BriteSmile Leasing, a subsidiary of the Company, in New Jersey state court. In this action, Nathoo alleges that the Company breached its agreement to pay Nathoo money and that such failure should result in the reversion of certain patent rights, which were previously assigned by Nathoo to the Company, back to Nathoo. Nathoo also seeks the payment of profits derived from the patent rights. The Company has filed an answer to the complaint, together with counterclaims alleging the same causes of action as in the Company's California litigation against Nathoo.

In May 2003, the court ordered that the case be transferred to California. In July 2003, the case was consolidated with the Discus Patent Litigation in California.

Smile Inc. Asia Pte. Ltd. v. BriteSmile

In April 2002, Smile Inc. Asia Pte. Ltd. ("Smile") sued the Company and BriteSmile Management, Inc., a wholly owned subsidiary of the Company, in Utah

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state court. The complaint alleges that BriteSmile Management breached its 1998 distributor agreement with Smile (exclusive as to Singapore and other surrounding countries) by failing to fill orders placed and to perform other obligations under the agreement. The complaint also alleges that BriteSmile Management and the Company fraudulently induced Smile to enter into the distributor agreement, and includes claims for alleged damages in amounts material to the Company, based on alleged unjust enrichment, civil conspiracy, breach of the duty of good faith and fair dealing, interference with contractual and economic relations, and fraudulent transfer.

The Company denies these allegations and believes the alleged damages are entirely unsupported, and will continue to vigorously defend this action.

In May 2002, the Company and BriteSmile Management filed their answer and counterclaim. The counterclaim alleges that Smile breached the distributor agreement by, among other things, failing to operate using a licensed dentist in good standing (the license of the principal of Smile, Dr. Tan, was revoked during 1999) and using BriteSmile's names and marks in a fashion not permitted by the distributor agreement.

One of the principal defenses to Smile's claims is that the distributor agreement expressly excludes "non-laser-aided teeth whitening products and processes" sold by the Company. Accordingly, in the lawsuit the Company asserts that Smile has no rights to market and sell the Company's current LATW or retail products and cannot claim damages for BriteSmile's marketing of such products in the exclusive territory described in the distributor agreement.

In May 2004, the Company filed a motion to compel Smile to participate in mandatory binding arbitration and to stay the litigation pending arbitration. In June 2004, the Court denied the Company's motion to compel arbitration. On July 16, 2004, the Company filed a Notice of Appeal on the issue of compelling this case to be decided by mandatory binding arbitration. The case is stayed at the trial level until the appellate court decides whether to compel Smile to participate in arbitration.

Both parties have produced documents and written responses in support of their claims and defenses, and depositions of certain key witnesses have been taken and are continuing. However, the Company is still waiting to receive from Smile documents and evidence to support Smile's calculation of damages.

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BriteSmile v. Discus Dental, Inc.

In May 2002, the Company filed a complaint against Discus Dental, Inc. in Contra Costa County Superior Court, California, alleging causes of action for intentional interference with contractual relationship, negligent interference with contractual relationship, violation of Unfair Business Practice Act - Loss Leader, violation of Unfair Business Practice Act, trade libel and injunctive relief. The complaint alleges that Discus Dental and other defendants yet to be identified wrongfully interfered with the Company's contractual relationships with its Associated Center Dentists, in part by writing letters with the purpose of inducing certain of the Company's Associated Dentists to terminate their contracts with the Company and switch to Discus' Zoom! system, and by making false and disparaging statements concerning the Company's teeth whitening system. The Complaint seeks damages for loss of business, punitive damages, injunctive relief, and costs of suit. This case was stayed in March 2003 pending the resolution of the Discus Patent Litigation.

Kalow & Springut v. BriteSmile et. al.

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In April 2003, the law firm of Kalow & Springut ("KS") filed a complaint against the Company, BriteSmile International, a subsidiary of the Company, and A.M. Pilaro, the Company's Chairman, in New York state court. KS seeks to recover alleged unpaid legal fees and expenses in the amount of \$768,000. Plaintiff also alleges that it was fraudulently induced to incur the legal fees and expenses and seeks to recover punitive damages of at least \$5 million.

On June 13, 2003, BriteSmile answered the Complaint and asserted counterclaims against KS for negligence, malpractice and breach of contract.

Discovery proceedings have commenced. Motions have been filed to dismiss all claims alleged against Mr. Pilaro and all claims alleged against the Company, except for one breach of contract claim. The Company has also applied to the court to compel KS to produce documents and to turn over certain Company files. On April 9, 2004, the court granted KS partial summary judgment in the amount of \$299,468.97, and denied summary judgment on the balance of the fees and disbursements claimed by KS. KS was ordered to turn over certain of BriteSmile's legal files. In addition, the court granted BriteSmile's motion to dismiss claims based on fraud, quasi-contract, unjust enrichment and quantum meruit, and denied all claims for punitive damages asserted by KS. All claims against Mr. Pilaro were dismissed.

BriteSmile has filed a Notice of Appeal to the Appellate Division of the Supreme Court of New York with respect to the partial summary judgment monetary award to KS. KS has filed a Notice of Cross-Appeal with respect to the dismissal by the trial court of various of its additional claims. Briefs and papers on the appeal will be prepared and submitted by early 2005 for argument at the March 2005 Term of the Appellate Division. Discovery continues in the trial court with respect to the unresolved part of the KS claim for legal fees and expenses. In addition, BriteSmile has moved the trial court for permission to add additional counterclaims of negligence and malpractice against KS.

The Procter & Gamble Company vs. Oraceutical LLC, IDEX Dental Sciences, Inc., Robert Eric Montgomery, BriteSmile, Inc. and BriteSmile Development, Inc.

This case was filed in the United States District Court for the Southern District of Ohio. In June 2003, The Procter & Gamble Company ("P&G") filed a complaint against the defendants listed above alleging that Oraceutical LLC, IDEX Dental Sciences, Inc. and Eric Montgomery (collectively, the "REM Group") had breached an agreement between the REM Group and P&G (the "Standstill Agreement") by entering into a binding memorandum of understanding (the "MOU") with the Company and BDI on May 9, 2003. Montgomery is a director of the Company. Oraceutical LLC, which is owned by Montgomery, is a consultant to the Company. The complaint also seeks a declaratory judgment that US Patent Nos. 5,922,307, 6,331,292 and 6,488,914 (owned by the REM Group at the time the complaint was filed) (the "Patents") are invalid and unenforceable, and that P&G's Whitestrips product does not infringe the Patents. In its complaint P&G asserts that the REM Group was obligated under the Standstill Agreement not to take any action that would prevent it from granting rights to P&G under the Patents sufficient at least for P&G's current Whitestrips products. P&G further

alleges that the REM Group breached that obligation by entering into the MOU and, accordingly, P&G terminated the Standstill Agreement. P&G is seeking monetary damages of at least \$75,000 from the Company under the claims set forth in its complaint. Defendants have filed a motion to dismiss P&G's declaratory judgment action for non-infringement and invalidity as well as for breach of the Standstill Agreement.

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In February 2004, the defendants filed an answer, affirmative defenses, and counterclaims. Affirmative defenses include anticipatory breach, unclean hands, equitable estoppel, lack of justiciable controversy, and lack of jurisdictional amount. The counterclaims asserted that P&G literally infringed U.S. Patent No. 6,488,914 by among other things, making, using, selling or offering to sell in the United States the Crest Whitestrips. The counterclaims further allege that P&G actively induced infringement of the patent in suit by providing marketing assistance for, advertising and otherwise promoting the Crest Whitestrips products to others for resale.

Discovery is proceeding, and both parties have served supplemental discovery responses including answers to interrogatories and responses to requests for production of documents.

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

Forward-looking Statements and Risk Factors

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 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 Center and Associated Center locations and revenues;
- o The loss of product market share to competitors and/or development of new or superior technologies by competitors;

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- o Ongoing operating losses associated with the development, marketing and implementation of new, light-activated teeth whitening technologies;

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- o Failure of the Company to secure additional financing to support the continued rollout of Centers and Associated Centers and to meet working capital requirements;
- 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 U.S. and non-U.S. markets; and
- o Lack of product diversity.

Critical Accounting Policies And Estimates

General

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to customer programs and incentives, bad debts, inventories, income taxes, warranty obligations, financing operations, restructuring, and contingencies and litigation. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

Revenue Recognition

BriteSmile recognizes revenue related to retail products at the time such products are sold to customers.

The Company recognizes revenue from teeth whitening procedures performed at its Centers when the procedures have been performed. The Company defers the revenue generated on the sale of key cards and activation codes to Associated Centers and recognizes the income over the estimated performance period.

BriteSmile's policy is not to accept any return of key cards or access codes during the course of the agreement with an Associated Center.

In the third quarter of 2004, BriteSmile introduced the BriteSmile Forever program where Center customers can pay an additional fee for the right to

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receive an unlimited number of touch-up procedures over a two-year period. The revenue associated with this program is deferred and recognized over the two-year period.

Deferred Contract Costs

During 1999, the Company granted warrants to OCA in consideration of OCA installing BS3000 machines in OCA centers. The value of the warrants was capitalized as deferred contract costs and is being amortized as a reduction of revenue over the life of the agreement (10 years).

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During 2003, the Company introduced the Magic Mirror, a marketing product designed to show potential customers what their teeth will look like after a LATW procedure. The Company provides the Magic Mirror to Associated Centers who sign a five year contract to purchase a minimum number of key cards each month. In accordance with EITF 01-09, "Accounting for Consideration Given to a Vendor by a Customer (Including the Reseller of a Vendor's Products)", the associated revenue and cost of the Magic Mirrors provided to customers have been capitalized and are being amortized to revenue and cost of goods sold over the life of the contract. The amount of deferred revenue and contract costs at September 25, 2004 was a net deferred cost of \$890,000.

Management will continually assess the recoverability of these costs.

Bad Debt

BriteSmile maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. A considerable amount of judgment is required in assessing the ultimate realization of accounts receivable including the current credit-worthiness of each Associated Center. If the financial condition of BriteSmile's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The allowance for doubtful accounts at September 25, 2004 was \$391,000.

Inventory

Inventories are stated at the lower of cost or market. BriteSmile writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions, as well as for damaged goods. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Property, Equipment and Improvements

BriteSmile evaluates its property, equipment and improvements for impairment whenever indicators of impairment exist. No impairment charge was recorded during the 39 weeks ended September 25, 2004. In the 39 weeks ended September 27, 2003, an impairment charge of \$273,000 was recorded related to the relocation of the Company's Houston Center.

Center Closures

During 2001, BriteSmile recorded significant reserves in connection with Center closures. These reserves include estimates pertaining to employee separation costs and the settlements of contractual obligations, primarily property leases. Although the Company does not anticipate significant changes, the actual costs related to the closures may differ from these estimates. The Company recorded an

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additional \$76,000 in the first quarter of 2004 for severance and lease liabilities associated with the closure of the Honolulu Center in January 2004. In total, the Center closure reserve decreased \$206,000 in the 39 weeks ended September 25, 2004, due to lease payments.

Overview

The following discussion should be read in conjunction with the Financial Statements and the Notes thereto included in Item 1 of this Quarterly Report on Form 10-Q and in the Company's Annual Report on Form 10-K for the fiscal year ended December 27, 2003.

Revenue and Deferred Contract Costs: See Revenue Recognition above.

Operating and occupancy costs are 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 lease costs for the devices in the Associated Centers; and 3) the operating and occupancy costs for the Centers.

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Selling, general and administrative expenses are composed of all selling and market support expenses as well as 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.

Research and development costs represent expenses related to safety and efficacy studies as well as other research activities directed at expanding the Company's leadership position in the teeth-whitening industry.

The following table sets forth unaudited operating results for the 13 week and 39 week periods ended September 25, 2004 and September 27, 2003, as a percentage of sales in each of these periods. This data has been derived from the unaudited financial statements.

| | 13 Weeks ended Sept 25, 2004 | 13 Weeks ended Sept 27, 2003 | 39 Weeks ended Sept 25, 2004 |
|---------------------------------------|------------------------------------|---------------------------------|------------------------------------|
| | ----- | ----- | ----- |
| Revenues: | | | |
| Center whitening fees, net | 36.6% | 40.4% | 37.4% |
| Associated Center whitening fees, net | 47.5% | 47.1% | 45.6% |
| Product sales | 15.9% | 12.5% | 17.0% |
| | ----- | ----- | ----- |
| Total revenues, net | 100.0% | 100.0% | 100.0% |
| | ----- | ----- | ----- |
| Operating Costs and Expenses: | | | |
| Operating and occupancy costs | 37.8% | 43.8% | 34.8% |

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| | | | |
|--|--------|--------|--------|
| Selling, general and administrative expenses | 66.1% | 76.8% | 60.8% |
| Research and development expenses | 0.9% | 3.5% | 1.2% |
| Depreciation and amortization | 14.2% | 14.8% | 13.8% |
| | ----- | ----- | ----- |
| Total operating costs and expenses | 119.0% | 138.9% | 110.6% |
| | ----- | ----- | ----- |
| Loss from operations | -19.0% | -38.9% | -10.6% |
| | ----- | ----- | ----- |
| Interest expense, net and other | -1.8% | -2.9% | -1.5% |
| | ----- | ----- | ----- |
| Loss before income tax provision | -20.8% | -41.8% | -12.1% |
| Provision for income taxes | 0.3% | 0.0% | 0.2% |
| | ----- | ----- | ----- |
| Net Loss | -21.1% | -41.8% | -12.3% |
| | ===== | ===== | ===== |

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The following are explanations of significant period-to-period changes for the 13 weeks ended September 25, 2004 and September 27, 2003:

Revenues

Total Revenues, net. Total revenues, net increased by \$0.4 million, or 4%, to \$11.9 million for the 13 weeks ended September 25, 2004, from \$11.4 million for the 13 weeks ended September 27, 2003.

Center Whitening Fees, net. Center whitening fees decreased by \$0.3 million or 6% to \$4.3 million for the 13 weeks ended September 25, 2004, from \$4.6 million for the 13 weeks ended September 27, 2003. The number of procedures performed in the Centers decreased 13% to 9,024 in the third quarter of 2004, compared to 10,361 in the same quarter of 2003. During August 2003, BriteSmile offered a Buy One Get One Free promotion resulting in a greater volume of procedures for the third quarter of 2003. Average whitening fees per procedure increased 8% from \$446 per procedure to \$482 per procedure in the third quarter of 2004, compared to the same quarter of 2003, as a result of reduced discounting. Generally, the level of discounting varies from period to period based on the market conditions at the time. The company cannot forecast future trends in this regard.

Associated Center Whitening Fees, net. Associated Center whitening fees, net increased by \$0.3 million, or 5%, to \$5.7 million for the 13 weeks ended September 25, 2004, from \$5.4 million for the 13 weeks ended September 27, 2003. The total number of procedures in all Associated Centers increased 7% to 35,765 procedures in the third quarter of 2004 compared to 33,270 procedures in the same quarter of 2003. Average whitening fees per procedure decreased 3% from \$162 per procedure to \$158 per procedure for the 13 weeks ended September 25, 2004, compared to the same period of 2003, primarily due to increased

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discounting. Generally, the level of discounting varies from period to period based on the market conditions at the time. The company cannot forecast future trends in this regard.

Product Sales and Other Revenue. Product sales increased by 31% to \$1.9 million for the 13 weeks ended September 25, 2004, from \$1.4 million for the 13 weeks ended September 27, 2003, primarily due to the sales of BriteSmile To Go (BTG), which was launched in the third quarter of 2003. Sales of BTG were \$0.8 million for the 13 weeks ended September 25, 2004. BTG is sold at Centers and Associated Centers, through partners such as Nordstrom and Henry Schein, directly by the Company's Call Center, and on the Company's website. Product sales also include the Company's toothpaste, mouthwash, whitening gum, toothbrushes and Magic Mirrors.

Operating Costs and Expenses

Operating and Occupancy Costs. Operating and occupancy costs as a percentage of net revenues was 38% for the 13 weeks ended September 25, 2004, compared to 44% in the 13 weeks ended September 27, 2003. This improvement was due to sales growth and a decrease in Occupancy & Operating expenses for the quarter compared to the same quarter in 2003. The major expense components in this category are cost of goods sold for all products and services, lease financing, and operating costs of Centers, which include salaries for the dentist and supporting staff, and rent. Cost of goods sold in the third quarter of 2003 reflects a \$343,000 inventory valuation adjustment.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased as a percentage of net revenues to 66% for the 13 weeks ended September 25, 2004 compared to 77% in the 13 weeks ended September 27, 2003. This improvement was due to sales growth and a decrease in SG&A expenses for the quarter compared to the same quarter in 2003. The \$0.9 million decrease in SG&A resulted from lower professional fees, and lower advertising and travel expenses, as well as a center restructuring accrual true-up that occurred in September 2003. Third quarter 2004 was also impacted by the accrual of all fees related to the separation of Bruce Fleming as CEO of the Company, and a \$0.75 million expense to BriteSmile required by accounting rules for certain consulting work initiated and paid for by a principal stockholder/related party.

Research and Development Expenses. Research and development expenses of \$110,000 were 1% of net revenues for the third quarter of 2004 compared to \$403,000, or 4%, in the corresponding period in 2003. The decrease in research and development expenses was primarily due to costs incurred with the development of the company's Magic Mirror in the third quarter of 2003 that were not incurred in the same quarter of 2004.

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Depreciation and Amortization. Depreciation and amortization decreased slightly as a percentage of net sales to 14% for the third quarter of 2004, compared to 15% in the corresponding period in 2003, as a result of sales growth. The net increase of \$4,000 in depreciation and amortization expense to \$1.7 million for the third quarter of 2004 is primarily due to higher amortization associated with the intellectual property purchased in the third quarter of 2003 of \$63,000, offset by lower depreciation of \$59,000 due to fixed assets becoming fully depreciated.

Interest Expense, net and other. Interest expense, net decreased \$117,000 to \$214,000, or 2% of net revenue for the third quarter of 2004 from \$331,000, or 3% of net revenue, for the corresponding period in 2003. The decrease was

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primarily due to lower debt balances in 2004.

The following are explanations of significant period-to-period changes for the 39 weeks ended September 25, 2004 and September 27, 2003:

Revenues

Total Revenues, net. Total revenues, net increased by \$5.0 million, or 16%, to \$36.4 million for the 39 weeks ended September 25, 2004, from \$31.4 million for the 39 weeks ended September 27, 2003.

Center Whitening Fees, net. Center whitening fees increased by \$1.6 million or 13% to \$13.6 million for the 39 weeks ended September 25, 2004, from \$12.0 million for the 39 weeks ended September 27, 2003. The number of procedures performed in the Centers increased 7% to 27,640 for the 39 weeks ended September 25, 2004, compared to 25,947 for the same period of 2003. The opening of the SoHo center in 2004 contributed to the increase in demand. Average whitening fees per procedure increased 6% from \$462 per procedure to \$492 per procedure for the 39 weeks ended September 25, 2004, compared to the same period of 2003, primarily due to reduced discounting. Generally, the level of discounting varies from period to period based on the market conditions at the time. The company cannot forecast future trends in this regard.

Associated Center Whitening Fees, net. Associated Center whitening fees, net increased by \$0.7 million, or 4%, to \$16.6 million for the 39 weeks ended September 25, 2004, from \$15.9 million for the 39 weeks ended September 27, 2003. The increase was primarily due to a 26% increase in procedures in International Associated Centers. The total number of procedures in all Associated Centers increased 9% to 104,440 procedures in the 39 weeks ending September 25, 2004, compared to 96,075 procedures in the same period of 2003. Average whitening fees per procedure decreased 4% from \$166 per procedure to \$159 per procedure for the 39 weeks ended September 25, 2004, compared to the same period of 2003, primarily due to increased discounting in the international market. Generally, the level of discounting varies from period to period based on the market conditions at the time. The company cannot forecast future trends in this regard.

Product Sales and Other Revenue. Product sales increased by 78.1% to \$6.2 million for the 39 weeks ended September 25, 2004, from \$3.5 million for the 39 weeks ended September 27, 2003, primarily due to sales of BriteSmile To Go (BTG), which was launched in the third quarter of 2003. Sales of BTG were \$3.4 million for the 39 weeks ended September 25, 2004. BTG is sold at Centers and Associated Centers, through partners such as Nordstrom and Henry Schein, directly by the Company's Call Center, and on the Company's website. Product sales also include the Company's toothpaste, mouthwash, whitening gum, toothbrushes and Magic Mirrors.

Operating Costs and Expenses

Operating and Occupancy Costs. Operating and occupancy costs as a percentage of net revenues was 35% for the 39 weeks ended September 25, 2004, compared to 41% for the 39 weeks ended September 27, 2003. This improvement was due to sales growth and a decrease in Occupancy & Operating expenses in the 39 weeks ended September 25, 2004 compared to the same period in 2003. The major expense components in this category are cost of goods sold, lease financing, and operating costs of Centers, which include salaries for the dentist and supporting staff, and rent. The \$184,000 decrease in Operating and Occupancy

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costs was primarily due to lower cost of goods sold of \$416,000, offset by higher Occupancy cost of \$232,000 in the 39 weeks ended September 25, 2004 when compared to the same period in 2003. Cost of goods sold for the 39 weeks ended September 27, 2003 reflects a \$343,000 inventory valuation adjustment.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased as a percentage of net sales to 61% in the 39 weeks ended September 25, 2004, compared to 70% in the corresponding period in 2003. This improvement was due primarily to sales growth in the 39 weeks ended September 25, 2004 compared to the same period in 2003. The \$0.1 million increase in SG&A resulted from lower advertising, salary, shipping, and travel expenses, offset by higher professional and consulting fees, and insurance costs. Consulting fees in 2004 include a \$0.75 million expense to BriteSmile required by accounting rules for certain consulting work initiated and paid for by a principal stockholder/related party.

Research and Development Expenses. Research and development expenses of \$425,000 decreased as a percentage of net revenues to 1% in the 39 weeks ended September 25, 2004 compared to \$772,000, or 2% in the corresponding period in 2003. The decrease in research and development expenses was primarily due to costs incurred with the development of the company's Magic Mirror and BTG products in 2003 that were not incurred in 2004.

Depreciation and Amortization. Depreciation and amortization decreased as a percentage of net sales to 14% for the 39 weeks ended September 25, 2004, compared to 16% in the corresponding period in 2003. The increase of \$160,000 in depreciation and amortization expense to \$5.0 million for the 39 weeks ended September 25, 2004 is primarily due to amortization associated with the intellectual property purchased in the third quarter of 2003 of \$390,000, offset by lower depreciation of \$230,000 due to fixed assets becoming fully depreciated..

Interest Expense, net and other. Interest expense, net decreased \$137,000 to \$534,000, or 2% of net revenue, for the 39 weeks ended September 25, 2004, from \$670,000, or 2% of net revenue, for the corresponding period in 2003. The decrease was primarily due to lower debt balances in 2004, as well as increased interest income from investments.

Liquidity and Capital Resources

General

The Company's principal sources of liquidity have been proceeds from issuances of common stock and debt. At September 25, 2004, the Company had \$8.3 million in cash and \$0.9 million in borrowing capacity under lines of credit. To date, the Company has yet to achieve net profitability. The Company expects that its principal uses of cash will be to provide working capital, to finance capital expenditures, and to meet corporate expenses.

During 2003, the Company obtained a \$2.5 million Center Loan with CAP America Trust, a related party. This credit facility is for general working capital needs (\$0.8 million) and capital expenditures and specific revenue generating initiatives (\$1.7 million). The Company has drawn \$1.6 million under this arrangement, leaving \$0.9 million currently available under this line.

Additionally, as discussed in "Sources of Cash" below, the Company obtained \$8.5 million of cash through a private placement of 923,943 shares of Company common stock to institutional investors, of which \$1.7 million was received in December 2003 and \$6.8 million was received in January 2004.

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The Company believes that cash on hand, together with available borrowing capacity discussed above and cash provided from operations, will be sufficient to sustain operations through the next twelve months.

Cash Requirements

During the last three years, the primary uses of cash were for funding of operations, purchases of property and equipment, and to a lesser degree, debt repayments. During the first quarter of 2004, the Company repaid a \$2 million

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bridge loan (including interest) obtained in November 2003, to LCO Investments Limited ("LCO"), a related party. LCO is the Company's primary shareholder. During the third quarter of 2004, the Company paid off a loan with a remaining principal amount of \$0.8 million obtained in March 2001, to Excimer Vision Leasing L.P. ("EVL"), a related party.

In December 2003, the Company and EVL amended their capital lease agreement to provide that the variable rent portion of the monthly payment due beginning November 2003 and the fixed rent portion of the monthly payment due beginning January 2004 would be deferred and paid to EVL on February 15, 2005, with interest payable on the deferred amount at a rate equal to LIBOR, plus 250 basis points. In August 2004, the Company and EVL further amended their capital lease agreement to provide that the total rents deferred under the December 2003 lease amendment would be deferred further such that \$1.0 million would be paid on February 15, 2005, \$1.0 million would be paid on February 15, 2006, and the remaining balance due would be paid on February 15, 2007. As of September 25, 2004, the unpaid variable rent was \$2.1 million, of which \$1.9 million is included in long-term debt.

The primary cash requirements of the Company are for maintaining current operations, debt service and capital expenditures to grow the network of Associated Centers and Company-managed Centers. In particular, spending on cost of goods, advertising, rents, leases and employee salaries is required to operate the business.

Sources of Cash, Liquidity and Capital Resources

In the 39 weeks ended September 25, 2004, the primary source of cash was the Company's private placement of 923,943 shares to institutional investors. The Company received \$1.7 million in December 2003 and the balance of \$6.3 million (net of fees) in January 2004. Proceeds from the private placement were used to retire the \$2 million bridge loan obtained by the Company in November 2003, as described above, and for working capital purposes.

During 2003 the Company converted to equity \$15.3 million of its interest-bearing debt, which will save the Company approximately \$0.5 million in interest expense in 2004.

Net cash provided from operations increased by \$3.5 million to \$0.4 million for the 39 weeks ended September 25, 2004, from \$3.1 million net cash used in 2003, primarily as a result of the substantial decrease in net loss partially offset by increased working capital requirements.

Net cash provided from financing activities was \$3.0 million for the 39 weeks ended September 25, 2004, compared to \$5.2 million for the same period in 2003. During the 39 weeks ended September 25, 2004, the Company both raised cash of \$6.8 million through equity offerings, and repaid debt of \$3.7 million. In the same period of 2003, the Company received debt financing of \$5.7 million, raised

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\$0.5 million from stock option exercises, and made payments on debt and capital leases of \$1.0 million.

Capital expenditures were \$1.0 million for the 39 weeks ended September 25, 2004, compared to \$3.7 million for the same period in 2003. The capital expenditures in the 39 weeks ended September 25, 2004 were primarily related to the completion of the Company's new Center in the SoHo district of New York. Investing activities in the 39 weeks ended September 27, 2003 included the intellectual property purchase of \$1.8 million.

While the Company does not maintain or invest in derivative financial instruments or deal in interest rate swaps, it does have debt obligations that are sensitive to changes in interest rates.

Inflation

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

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The Company believes that its business follows seasonal trends due to increased consumer demand during the spring and around public and national holidays. As a result, the Company's sales performance could potentially be affected.

ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURE ABOUT MARKET RISK

We believe there has been no material change in our exposure to Market Risk from that discussed in our 2003 Annual Report on Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

During 2003, the Company identified an error in the recording of cost of sales. This error resulted in the Company restating its financial statements for the 13-week period ended June 28, 2003. The error was the result of weaknesses in the Company's internal inventory control structure. Deloitte & Touche LLP communicated to management and the Audit Committee that these weaknesses are considered material weaknesses. Management and the Audit Committee identified and have commenced implementing certain changes that they feel are necessary to strengthen the Company's accounting and reporting function, including capabilities of its accounting personnel and adoption of more frequent reviews and reconciliations of financial information. Management continues to evaluate its control structure, to identify issues and resolve them in as timely a manner as possible.

The Company's Management, with the participation of our Chief Executive Officer and our Chief Financial Officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures" (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this Report. Based upon their evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded, except as noted above, that the Company's disclosure controls and procedures are effective.

Other than those discussed above, there were no significant changes in our

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internal controls or in other factors that could significantly affect our internal controls subsequent to the Evaluation Date.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is the subject of certain legal actions. Management does not believe that current pending litigation involving the Company will have a material adverse effect on the Company's consolidated financial position or results of operations. This conclusion has been developed in consultation with outside counsel handling BriteSmile's defense in the matters. However, the litigation and other claims noted in this report are subject to inherent uncertainties and it is possible that future results of operations for any particular quarterly or annual period could be materially affected by changes in management's assumptions and the effectiveness of BriteSmile's strategies related to these legal actions.

BriteSmile, Inc. v. Discus Dental, Inc. and Salim Nathoo, U.S. District Court for the Northern District of California

See the Company's Quarterly Report on Form 10-Q for the 13 weeks ended June 26, 2004, in which this legal proceeding was reported.

In August 2004, Mr. Salim Nathoo filed an amended answer and counterclaims to the Company's Third Amended Complaint. Nathoo's amendment supplements the answers and counterclaims he initially filed in April 2004. In his new amended counterclaims, Nathoo brought claims for correction of inventorship of several of the Company's patents; infringement by the Company of those same patents; misappropriation of trade secrets by the Company and selected named Company

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employees or directors; conversion by the Company, and named Company employees or directors; constructive trust for the patents he claims have incorrect inventorship; fraud against and breach of contract by the Company and selected named Company employees and directors and CAP Advisors Limited; tortious interference with contract by the Company; a declaration that the Company has no protectable trade secrets; and unfair competition against the Company and selected named Company officers and directors. In October 2004, Nathoo filed another amended answer and counterclaims in which he dropped his allegations of patent infringement.

The Company is seeking compensatory and punitive damages against Discus and compensatory damages against Nathoo. The exact amount of damages sought by both defendants has not yet been determined.

Salim Nathoo v. BriteSmile Leasing

In May 2003, this case was consolidated with the BriteSmile v. Discus Dental lawsuit discussed above. See the Company's Quarterly Report on Form 10-Q for the 13 weeks ended June 26, 2004, in which this legal proceeding was reported.

Smile Inc. Asia Pte. Ltd. v. BriteSmile

See the Company's Quarterly Report on Form 10-Q for the 13 weeks ended June 26, 2004, in which this legal proceeding was reported.

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In May 2004, the Company filed a motion to compel Smile Inc. Asia Pte. Ltd. ("Smile") to participate in mandatory binding arbitration and to stay the litigation pending arbitration. In June 2004, the Court denied the Company's motion to compel arbitration. On July 16, 2004, the Company filed a Notice of Appeal on the issue of compelling this case to be decided by mandatory binding arbitration. The case is stayed at the trial level until the appellate court decides whether to compel Smile to participate in arbitration.

Both parties have produced documents and written responses in support of their claims and defenses, and depositions of certain key witnesses have been taken and are continuing. However, the Company is still waiting to receive from Smile documents and evidence to support Smile's calculation of damages.

BriteSmile v. Discus Dental, Inc., Contra Costa County Superior Court, California

See the Company's Quarterly Report on Form 10-Q for the 13 weeks ended June 26, 2004, in which this legal proceeding was reported.

Kalow & Springut v. BriteSmile et. al.

See the Company's Quarterly Report on Form 10-Q for the 13 weeks ended June 26, 2004, in which this legal proceeding was reported.

BriteSmile has filed a Notice of Appeal to the Appellate Division of the Supreme Court of New York with respect to the partial summary judgment monetary awarded on April 9, 2004 to Kalow & Springut in the amount of \$299,468.97. KS has filed a Notice of Cross-Appeal with respect to the dismissal by the trial court of various of its additional claims. Briefs and papers on the appeal will be prepared and submitted by early 2005 for argument at the March 2005 Term of the Appellate Division. Discovery continues in the trial court with respect to the unresolved part of the KS claim for legal fees and expenses. In addition, BriteSmile has moved the trial court for permission to add additional counterclaims of negligence and malpractice against KS.

The Procter & Gamble Company vs. Oraceutical LLC, IDEX Dental Sciences, Inc., Robert Eric Montgomery, BriteSmile, Inc. and BriteSmile Development, Inc.

See the Company's Quarterly Report on Form 10-Q for the 13 weeks ended June 26, 2004, in which this legal proceeding was reported.

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ITEM 2. CHANGES IN SECURITIES.

During the 13 week period ended September 25, 2004, the Company granted to key employees and directors under its 1997 Stock Option and Incentive Plan non-qualified options to purchase an aggregate of 29,000 shares of the Company's common stock, at exercise prices ranging from \$9.72 to \$10.02 per share. The options vest over a period of time following their respective dates of grant.

For all option grants, the Company claimed exemption from registration under the Securities Act of 1933 in that the Company believes such grants were not "sales" within the meaning of the Act. Shares issuable upon exercise of the options have been or will be registered with the SEC pursuant to Registration Statements on Form S-8.

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ITEM 3. DEFAULT UPON SENIOR SECURITIES.

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

ITEM 5. OTHER INFORMATION.

On November 8, 2004, the Company filed a Current Report on Form 8-K for the purpose of furnishing to the Commission a copy of its earnings release for the 13 weeks ended September 25, 2004. Certain Balance Sheet balances related to debt as of September 25, 2004 included in that Current Report are hereby re-classified as follows: "Current portion of long-term debt and capital lease obligations" is changed from \$3,655,000 to \$1,717,000 resulting in "Total current liabilities" of \$13,272,000; and "Long-term debt and capital lease obligations" is changed from \$3,626,000 to \$5,564,000, resulting in "Total long-term liabilities" of \$6,999,000.

The Balance Sheets of the Company contained in this Quarterly Report on Form 10-Q for the 13 weeks ended September 25, 2004 reflect the corrected classification.

ITEM 6. EXHIBITS.

- 31.1 Certification of Acting Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 32.1 Certification of Acting Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

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/ Anthony M. Pilaro

Anthony M. Pilaro
Acting Chief Executive Officer

November 9, 2004

Date

/s/ Ken Czaja

November 9, 2004

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Ken Czaja
Chief Financial Officer

Date