

Edgar Filing: BSML INC - Form 10-Q

BSML INC  
Form 10-Q  
November 15, 2006

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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 30, 2006

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

For the Transition Period from to \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-11064

BSML, INC.

-----  
(Exact name of registrant as specified in its charter)

UTAH

87-0410364

-----  
(State or other jurisdiction of incorporation or organization)

-----  
(IRS employer identification no.)

460 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: BriteSmile, Inc.

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

[ ] Yes  [X] No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

[ ] Yes  [X] No

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

Yes  [X] No  [ ]

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

BSML, Inc. had 10,549,423 shares of common stock outstanding at September 30, 2006.

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### BSML, INC. AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BSML, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (\$ in thousands, except share data)

	September 30, 2006
	----- (unaudited)
<b>ASSETS</b>	
<b>CURRENT ASSETS:</b>	
Cash and cash equivalents .....	\$ 5,692
Trade accounts receivable, net of allowances .....	610
Inventories .....	926
Assets held for sale .....	--
Cash, restricted as to use .....	3,500
Prepaid expenses and other .....	473
	-----
Total current assets .....	11,201
	-----
Property and equipment, net .....	4,640
Cash, restricted as to use .....	7,812
Other assets .....	924
	-----
<b>TOTAL ASSETS .....</b>	<b>\$ 24,577</b>
	=====
<b>LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)</b>	
<b>CURRENT LIABILITIES:</b>	
Accounts payable .....	\$ 2,027
Accrued liabilities .....	14,377
Accrual for Center closures .....	179
Gift certificates and prepaid appointments .....	982
Smile Forever - deferred revenue .....	1,872
Liabilities held for sale .....	--
Accrued interest due to a related party .....	--
Long-term debt with related party - current portion .....	--
Convertible debt - current portion .....	--
Convertible debt with a related party - current portion .....	--
Financial instruments related to convertible debt - current portion .....	--
Capital lease obligations with related parties - current portion .....	--
	-----
Total current liabilities .....	19,437

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LONG TERM LIABILITIES:

Accrual for Center closures .....	331
Other long-term liabilities .....	935
Smile Forever deferred revenue .....	972
<hr/>	
Total long-term liabilities .....	2,238
<hr/>	
Total liabilities .....	21,675
<hr/>	

SHAREHOLDERS' EQUITY (DEFICIT):

Common stock, \$.001 par value; 50,000,000 shares authorized; 10,549,423 shares issued and outstanding for September 30, 2006 .....	38
10,549,130 shares issued and outstanding for December 31, 2005 .....	--
Preferred Stock, no par value; 5,000,000 shares authorized and none issued or outstanding .....	--
Additional paid-in capital .....	173,516
Accumulated deficit .....	(170,652)
<hr/>	
Total shareholders' equity (deficit) .....	2,902
<hr/>	

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT) ..... \$ 24,577

See notes to condensed consolidated financial statements.

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

	13 Weeks Ended September 30, 2006	13 Weeks Ended September 24, 2005	Se
	<hr/>	<hr/>	
<b>REVENUES</b>			
Center whitening fees, net .....	\$ 5,768	\$ 4,178	\$
Product and other revenue .....	943	972	
	<hr/>	<hr/>	
Total revenues, net .....	6,711	5,150	
<b>OPERATING COSTS AND EXPENSES:</b>			
Operating and occupancy costs .....	3,714	3,420	
Selling, general and administrative expenses .....	8,726	3,742	
Research and development expenses .....	45	266	
Depreciation and amortization .....	415	660	
	<hr/>	<hr/>	
Total operating costs and expenses .....	12,900	8,088	
	<hr/>	<hr/>	
Loss from operations .....	(6,189)	(2,938)	

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OTHER INCOME AND EXPENSES:			
Amortization of discount on debt .....	-	(652)	
Loss on early extinguishment of debt .....	-	-	
Gain (loss) on mark-to-market of financial instrument related to convertible debt.....	-	1,163	
Gain on settlement of legal claim .....	-	-	
Other income (expense), net .....	185	(251)	
	-----	-----	
Loss from continuing operations before income tax .....	(6,004)	(2,678)	
INCOME TAX .....	(271)	30	
	-----	-----	
Net loss from continuing operations .....	(5,733)	(2,708)	
	-----	-----	
Discontinued Operations:			
Gain (loss) from discontinued operations, net of tax (39 weeks ended September 30, 2006 includes gain from sale of business, \$ 14,664, and gain from lawsuit settlement, \$5,202, net of tax) .....	-	(1,777)	
	-----	-----	
Net Income (loss) .....	\$ (5,733)	\$ (4,485)	\$
	-----	-----	
NET LOSS PER SHARE - BASIC AND DILUTED:			
Basic and diluted net loss per common share from continuing operations .....	\$ (0.54)	\$ (0.25)	\$
	-----	-----	
Basic and diluted net gain/(loss) per common share from discontinued operations .....	\$ -	\$ (0.17)	\$
	-----	-----	
Basic and diluted net gain/(loss) per common share .....	\$ (0.54)	\$ (0.42)	\$
	-----	-----	
Weighted average shares - basic .....	10,549,423	10,549,130	
Weighted average shares - diluted .....	10,549,423	10,549,130	
	-----	-----	

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BSML, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
UNAUDITED  
(\$ in thousands, except share data)

		39 Weeks Ended September 30, 2006
		-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss from continuing operations .....	\$	(14,427)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization .....		1,234
Loss on disposal of Assets .....		109
Non-cash compensation expense .....		156

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Impairment of deferred cost asset .....	-
Amortization of discount of debt .....	530
Gain on mark-to-market of financial instruments related to convertible debt .....	-
Non-cash early extinguishment of debt .....	5,038
Expenses paid by related party .....	20
Change in assets and liabilities net - continuing operations .....	1,595
	-----
Net cash provided by (used) in operating activities - continuing operations ..	(5,745)
Net cash provided by (used) in operating activities - discontinued operations	7,984
	-----
Net cash provided by (used in) operating activities .....	2,239
	-----
 CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from sale of assets held for sale - Associated Centers business .....	26,82
Cash restricted as to use/Other .....	(9,841)
Proceeds/(disbursement) from selling/(buying) investment .....	122
Purchase of property and equipment .....	(46)
Investment in Thai Spa .....	-
	-----
Net cash used in investing activities-continuing operations .....	17,059
Net cash used in investing activities-discontinued operations .....	-
	-----
Net cash provided by (used in) investing activities .....	17,059
 CASH FLOWS FROM FINANCING ACTIVITIES:	
Payments on capital lease .....	(73)
Payments on debt .....	(19,051)
Proceeds from exercise of stock options and warrant exercises .....	-
Proceeds from stock option issuance .....	-
	-----
Net cash used in financing activities .....	(19,124)
	-----
NET DECREASE IN CASH AND CASH EQUIVALENTS .....	174
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD .....	5,518
	-----
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD .....	\$ 5,692
	=====
 SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:	
Cash paid for income taxes .....	\$ 89
	=====
Cash paid for interest .....	\$ 1,446
	=====

BSML, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)  
SEPTEMBER 30, 2006

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### 1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

#### DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

BSML, Inc., a Utah corporation ("BSML" or the "Company", formerly BriteSmile, Inc.), and its affiliates market and sell advanced teeth whitening products and services through 17 Professional Teeth Whitening Centers ("Centers"). Prior to March 13, 2006, the Company also offered its products and technologies through arrangements with existing independent dental offices known as BriteSmile Professional Teeth Whitening Associated Centers ("Associated Centers"). The Company's business is focused on one industry segment, products and procedures to whiten teeth.

On March 13, 2006, the Company and its wholly owned subsidiaries, BriteSmile International Limited, an Ireland corporation, and BriteSmile Development, Inc., a Delaware corporation (collectively, the "Sellers") completed an asset sale with Discus Dental, Inc., a California corporation ("Discus"), whereby Discus acquired the assets and the operations of the Associated Centers for approximately \$26.3 million plus the assumption of certain operating liabilities, and the Company settled its litigation with Discus for \$8.7 million, resulting in total consideration of approximately \$35 million to the Company.

On May 1, 2006, the Company gave notice to Dental Spas, LLC, an Iowa limited liability company ("Dental Spas"), that the Company was exercising its right to terminate the Limited Liability Company Membership Purchase Agreement (the "Purchase Agreement") dated January 13, 2006 between the Company and Dental Spas. A copy of the Purchase Agreement was filed as an exhibit to the Company's Form 8-K filed with the Securities and Exchange Commission on January 19, 2006. The agreed closing conditions were not satisfied and pursuant to its terms, the Company terminated the Purchase Agreement. The Board of Directors of the Company determined that it was in the best interests of the Company's shareholders to terminate the Purchase Agreement with Dental Spas.

Since the agreement with Dental Spas to sell the Centers business was terminated on May 1, 2006 and the Company continues to operate the Centers business, the results of operations and financial position of the Centers business for all periods presented in this report have been reclassified as continuing operations. All assets and liabilities related to Centers that were previously classified as held for sale have been reclassified as held and used assets. The results of operations for the Associated Centers business, which was sold in March 2006, for all periods presented in this report have been presented as discontinued operations. All assets and liabilities related to Associated Centers were classified as held for sale and in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

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 39 weeks ended September 30, 2006 are not necessarily indicative of the results that may be expected for the remainder of the fiscal year ending December 30, 2006.

#### GOING CONCERN

To date, the Company has yet to achieve consistent bottom-line

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profitability. The Company's principal sources of liquidity historically have been proceeds from issuance of common stock and debt and related financial instruments, and more recently, from the sale of its Associated Centers business. At September 30, 2006, the Company had \$5.7 million in unrestricted cash. The Company's outstanding long-term debt was fully paid in March 2006 from the proceeds of the sale transaction with Discus in March 2006 as required by consents obtained from certain debt holders of the Company. As of September 30, 2006, the Company had \$11.3 million in restricted cash, including \$3.5 million held in escrow related to the sale of the Associated Centers business until June 2007. Also included in this restricted cash balance is \$6.5 million as a result of a court writ of attachment in connection with the litigation with Mayer, Brown, Rowe & Maw LLP. (See Note 8). The remaining restricted cash amount of \$1.3 million is related to merchant banking reserve requirements and spa lease security requirements. This amount is included in "Cash, restricted as to use" on the balance sheet.

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Furthermore, the Company has agreed to a standby \$1.5 million writ of attachment in connection with the Smile Asia Pte, Inc. litigation (See note 7), if and when the \$6.5 million writ of attachment from the Mayer Brown litigation is discharged or terminated. The Mayer Brown cash restriction, and any other additional cash restriction, could have a significant adverse impact on the Company's ability to fund operations in the near term.

The Company currently is able to pay its debts as they come due. However, the Company is not yet sure that it will be able to achieve bottom-line profitability on a sustained basis, primarily due to the unknown level of costs associated with its legal claims in future months. Because of this uncertainty of the outcome of legal claims against the Company and the related amount of their future legal defense costs, the Company is not certain that its unrestricted cash will be sufficient to maintain operations at least through the next twelve months. Accordingly, BSML management believes that these factors raise doubt as to whether the going concern basis of accounting reflected in these financial statements continues to be appropriate. Our liquidity projections may improve or deteriorate depending on these changing conditions.

### RECENT ACCOUNTING PRONOUNCEMENTS

In July 2006, the FASB issued FASB Interpretation No.48, Accounting for Uncertainty in Income Taxes—an interpretation of FAS 109. This interpretation clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Interpretation No. 48 is effective for fiscal years beginning after December 15, 2006. Earlier application is encouraged if the Company has not yet issued financial statements, including interim financial statements, in the period Interpretation No. 48 is adopted. The Company has evaluated the impact of the adoption of FASB No.48, and does not believe the impact will be significant to the Company's overall results of operations or financial position.

On September 9, 2006, the FASB issued FASB statement No.157. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the



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relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. FAS 157, Fair Value Measurements, is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company has evaluated the impact of the adoption of FASB No.157, and does not believe the impact will be significant to the Company's overall results of operations or financial position.

On September 9, 2006, the FASB issued a statement No. 158. This Statement improves financial reporting by requiring an employer to recognize the over-funded or under-funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. This Statement also improves financial reporting by requiring an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year end statement of financial position shall be effective for fiscal years ending after December 15, 2008, and shall not be applied retrospectively. The Company has evaluated the impact of the adoption of FASB No.158, and does not believe the impact will be significant to the Company's overall results of operations or financial position.

### 2. STOCK BASED COMPENSATION

Effective January 1, 2006, we adopted FAS 123(R), which requires that compensation cost relating to share-based payment transactions be recognized in our financial statements. We have adopted FAS 123(R) on a modified prospective basis, which requires that compensation cost relating to all new awards and to awards modified, repurchased, or cancelled be recognized in our financial statements beginning January 1, 2006. Additionally, compensation cost for the portion of awards for which the requisite vesting period has not been completed that are outstanding as of January 1, 2006 will be recognized as the requisite vesting is rendered on or after January 1, 2006. The pro forma disclosures previously permitted under SFAS No. 123, "Accounting for Stock-Based Compensation," are no longer an alternative to financial statement recognition.

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In January 1997, the Company adopted the 1997 Stock Option and Incentive Plan (the "1997 Plan"). Under the terms of the 1997 Plan, as amended to date, and as approved by the Company's shareholders, 1,900,000 of the Company's common stock shares are available for issuance. Options may be granted at exercise prices of no less than the fair market value on the date of the grant, as determined by the Board of Directors and quoted market prices. Options generally vest over a two to five-year period and have a maximum term of ten years.

For the 39-weeks period ended September 30, 2006, the Company recognized compensation costs of \$155,748 as a result of the adoption of SFAS 123R.

Based on current assumptions and option grants, the remaining value expected to be recognized as compensation cost in the future is approximately \$190,000.

The following table represents stock option activity for the 39 weeks period ended September 30, 2006:

	Number of Shares	Wtd-Average Exercise Price
--	---------------------	-------------------------------

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	-----	-----
Outstanding options at beginning of period	835,791	\$ 11.83
Granted	0	\$ 0
Exercised	0	\$ 0
Forfeited	339,429	\$ 8.36
Outstanding options at the end of the period	496,362	\$ 14.21
Exercisable options at the end of the period	460,365	\$ 14.59

We use the Black-Scholes option pricing model to estimate the fair value of stock-based awards with the following assumptions:

	13 WEEKS ENDED September 30, 2006	39 WEEKS ENDED September 30, 2006
Risk-free interest rate	4.37%	4.37%
Expected life of options (in years)	2.66	2.66
Expected volatility	121%	121%
Expected dividend yield	--	--
Forfeiture rate per year	10%	21%*

- o Forfeiture rate for 39 weeks ended September 30, 2006 represents the average forfeiture rate used in the first three quarters of 2006.

The assumptions above are based on multiple factors, including historical exercise patterns of employees. We use historical data to estimate the options' expected term, which represents the period of time that options granted are expected to be outstanding. Volatility is also based on historical run-rate. Since we have never paid any dividends and do not anticipate paying any dividends at least through the expected life of our stock options outstanding, we use an expected dividend yield of zero when calculating the fair value of stock options. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve.

FAS 123(R) requires that we estimate forfeitures, or the number of shares that are expected to be cancelled prior to vesting, at the time of grant, and adjust for actual forfeitures in subsequent periods if they differ from our original estimates. In the third quarter ended September 30, 2006, the expected future forfeiture rate was revised down to 10% to reflect the fact that the Company had completed virtually all of the unusually high level of employment terminations associated with the restructuring of the Company after the sale of the AC business in March 2006. In the Company's pro-forma information required under FAS 123 for the periods prior to fiscal 2006, we accounted for forfeitures as they occurred.

For the prior year 13 and 39 week periods ended September 24, 2005, had compensation expense for the Company's employee stock option awards been determined based on the Black-Scholes fair value at the grant dates for awards under those plans consistent with the fair value method of FAS 123, the Company would have recorded additional compensation expense and its net loss and loss per share would have been changed to the pro forma amounts presented in the following table:

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	SEPTEMBER 24, 2005	SEPTEMBER 24, 2005
	-----	-----
Reported net loss	\$ (4,485)	\$ (14,477)
Compensation expense for stock options	(116)	(830)
Pro forma net loss	\$ (4,601)	\$ (15,307)
Pro-Forma Net loss per share -- basic and diluted:	\$ (0.43)	\$ (1.45)

Total compensation cost for share-based payment arrangements recognized in income for the 39-week period ended September 30, 2006 was \$155,748. We did not recognize any material tax benefit related to these share-based arrangements as we have been in a loss position historically and have a full valuation allowance against our tax benefits.

### 3. INCOME/LOSS PER COMMON SHARE

Basic net income/loss per share is calculated as net income/loss divided by the weighted-average number of common shares outstanding. For the 39-week period ended September 30, 2006, stock options and warrants totaling 16,306 shares have been included in the calculation of diluted net income per share, as their effect is dilutive. Stock options and warrants totaling the following number of shares have been excluded from the calculation of net loss per share for the following periods in this report, as their effect is anti-dilutive:

Period	Number of Option and Warrant Shares
-----	-----
13 Weeks Ended September 30, 2006	864,252
13 and 39 Weeks Ended September 24, 2005	2,377,011

### 4. DISCONTINUED OPERATIONS

During 2005, the Company's Board of Directors took various actions to evaluate the long-term prospects for continuing to operate the Company's Associated Centers and Centers businesses. In mid-2005, the Board of Directors and management had committed to seek potential buyers of both the Associated Centers and the Centers. This search had identified buyers where a deal appeared probable within the next twelve months and the operations were ready for immediate sale. Therefore, the operations of the Associated Centers and the Centers had been accounted for as discontinued operations as prescribed by Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" for the entire year of 2005 and first two quarters of 2006.

On March 13, 2006, BSML completed an asset sale with Discus, whereby Discus acquired the assets and the operations of the Associated Centers for approximately \$26.3 million plus the assumption of certain operating liabilities and settled our litigation with Discus for \$8.7 million, resulting in total consideration of approximately \$35 million to BSML. The assets sold to Discus included certain intangible assets and proprietary rights related to the Associated Centers business, including the BriteSmile name and trademark, and substantially all of the intellectual property rights. Discus acquired intellectual property subject to certain existing technology and trademark licenses in favor of Sellers that permit the operation of the Centers and sales of certain retail products under the BriteSmile trademark. Discus also acquired all of the rights and claims against third parties relating to the intellectual property, except for claims against third parties who may have infringed certain patents in the whitening strips field, which were retained under a license from

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Discus.

During the first quarter of 2006, Dental Spas agreed to purchase the Company's Centers business. The purchase price was approximately \$20 million, plus the assumption of certain continuing obligations. In addition, the sale was to include the Company's business of selling teeth whitening products, including its BriteSmile-to-Go whitening pen, toothpaste and mouthwash products, directly and through third party retail channels. However, on May 1, 2006, the closing conditions set forth in the Purchase Agreement were not satisfied and pursuant to its terms, the Company terminated the Purchase Agreement. The Board of Directors of the Company determined that it was in the best interest of the Company's shareholders to terminate the Purchase Agreement with Dental Spas and to continue to operate the Centers.

The financial statements included in this report have been prepared in accordance with the Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". As a result of the events that occurred over the last 39 week period related to the Associated Centers business and the Centers business, the results of operations for the Associated Centers for all periods presented have continued to be reflected as discontinued operations. However, the results of operations for the Centers business have been presented as continuing operations for all periods presented in this report, due to the termination of the purchase agreement with Dental Spas on May 1, 2006. All assets and liabilities related to the discontinued operations of the Associated Centers business are classified as held for sale for all comparative reporting periods presented.

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The assets and liabilities that are shown as held for sale on the Balance Sheet as of December 31, 2005 reflect the assets & liability of the discontinued Associated Center business, and are as follows (\$ Thousands):

	December 31, 2005
	-----
Assets held for sale:	
Accounts receivable, net	1,479
Inventories	541
Prepaid expense and other	220
Property and equipment	4,403
Intangibles	4,839
Other assets	732
	-----
Total Assets held for sale	\$ 12,214
Liabilities held for sale:	
Gift certificates and prepaid appointments	60
Deferred revenue	430
Other long term liabilities	313
	-----
Total Liabilities held for sale	\$ 803

### 5. DEBT

The Company utilized proceeds received from selling its Associated Centers business in March 2006 to pay off all long-term debt, capital leases and accrued interest. Previously, the Company's note payable held by LCO Investments Limited and the Company's convertible debt had unamortized discounts totaling \$5.0 million. The Company had been amortizing these discounts over the life of the debt instrument. Concurrent with the debt pay off, the Company recorded a loss in March 2006 on the early extinguishment of debt to record the unamortized

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discount in the statement of operations.

Prior to March 2006, the Company had certain financial instruments related to its convertible debt. The estimated fair value amounts were determined using appropriate market information and valuation methodologies. In the measurement of the fair value of these instruments, the Black-Scholes option pricing model was utilized, which is consistent with the Company's historical valuation techniques. The value of the Financial Instruments Related to Convertible Debt - Conversion Feature was treated as a liability and marked-to-market based on the current stock price with the resulting gain or loss reflected in the income statement. In addition, all note holder warrants related to this debt were cancelled upon payoff of the notes in March 2006.

### 6. RELATED PARTY PAYMENTS

THE FOLLOWING TABLE SUMMARIZES THE AMOUNTS PAID TO RELATED PARTIES IN THE FIRST THREE QUARTERS OF 2006 and 2005:

RELATED PARTY	DESCRIPTION OF RELATIONSHIP	SOURCE OF DEBT OR OBLIGATION	13 WEEK ENDED SEPTEMBER 30, 2006	13 WEEK ENDED SEPTEMBER 24, 2005	3
-----	-----	-----	-----	-----	-----
Oraceutical, LLC	A former board member is a co-founder and managing director of Oraceutical	Merchandise/Pack out charges and order fulfillment services	\$ 670,452	\$ 356,000	\$
Oraceutical, LLC	A former board member is a co-founder and managing director of Oraceutical	Consulting	\$ 45,000	\$ 45,000	\$
LCO Properties, Inc.	Deemed affiliate of the chairman of the board	Monthly rent for New York Center	\$ 149,128	\$ 143,000	\$
LCO Investments Limited	Deemed affiliate of the chairman of the board	Interest and pay off of debt and pay out for preferred stock	0	\$ 58,000	\$
CAP America Trust	Deemed affiliate of the chairman of the board	Interest and pay off of debt	0	\$ 24,000	\$
Excimer Vision Leasing	Deemed affiliate of the chairman of the board	Variable fees, fixed fees, pay off of deferred lease balance	0	\$ 740,000	\$

In total, the Company paid related parties \$ 1,366,000 during the 13 weeks ended

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09/24/2005, and \$ 864,580 during the 13 weeks ended 09/30/2006. The Company paid related parties \$ 4,531,000 during the 39 weeks ended 9/24/2005, and \$ 11,372,446 during the 39 weeks ended 9/30/2006.

### 7. LEGAL PROCEEDINGS

The Company is the subject of certain legal actions. Management believes that it has accrued the appropriate amount of liability for actions against the Company. 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 BSML's strategies related to these legal actions.

The following matters pending on December 31, 2005 or commenced thereafter,  
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have been settled:  
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BSML, Inc. v. Discus Dental, Inc. and Salim Nathoo, filed in federal court in California (the "Discus Patent Litigation"). This case was dismissed with prejudice in March 2006. The Company filed a complaint against Discus Dental, Inc. ("Discus") in July 2002, and added Salim Nathoo ("Nathoo") as a defendant in February 2003. As subsequently amended, the complaint asserted claims of patent infringement, misappropriation of the Company's trade secrets, civil conspiracy, and unfair competition and business practices by Discus and Nathoo jointly and other claims against Discus and Nathoo, individually. Discus filed counterclaims seeking declarations of invalidity and non-infringement of several BriteSmile patents, and for other claims.

On March 13, 2006, the parties settled all litigation proceedings between them, including the Discus Patent Litigation and the litigation described in the two following paragraphs. Discus and the Company agreed to settle the Discus Patent Litigation and the litigation described in the following two paragraphs for consideration to the Company of \$8.7 million.

BriteSmile Development, Inc. v. Discus Dental, Inc. BriteSmile Development, Inc. ("BDI"), a wholly owned subsidiary of BSML, Inc. filed in October 2005, a patent infringement suit against Discus in federal court in California. The suit alleged that Discus' Zoom! 2 tooth whitening system infringed a patent issued to BDI in October 2005. This case was dismissed in March 2006, as described above.

BriteSmile v. Discus Dental, Inc., filed in May 2002 in California state court. The Company filed a complaint against Discus alleging state law causes of action for intentional interference with contractual relationship, negligent interference with contractual relationship, unfair business practices and related claims. This case was dismissed in March 2006, as described above.

The Procter & Gamble Company v. Oraceutical LLC, IDEX Dental Sciences, Inc., Robert Eric Montgomery, BriteSmile, Inc. and BriteSmile Development, Inc., filed in June 2003 in federal court in Ohio. This case was dismissed in February 2006 in connection with a settlement payment from the Procter & Gamble Company ("P&G"). In its complaint P&G alleged 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 in May 2003. Montgomery is a former director of the Company, and Oraceutical LLC, which is owned by Montgomery, is a consultant to the Company. The complaint also sought a declaratory judgment that certain U.S. patents previously owned by the Company (but owned by the REM Group at the time the complaint was filed) (the "Patents") were invalid and unenforceable, and that P&G's Whitestrips product did not infringe the Patents. In February 2004, the

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defendants filed an answer and counterclaims.

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In February 2006 the parties settled the litigation proceedings between them. As part of the settlement, the Company granted to P&G a nonexclusive license to certain patents relating to teeth whitening strips and P&G agreed to pay \$4 million. The Company recorded a gain of approximately \$1.3 million from its portion of the settlement proceeds.

Green River Junction v. BriteSmile, filed in November 2005, in Pennsylvania state court. In its complaint Green River Junction, Inc. ("Green River") sought to recover approximately \$85,000 from the Company on breach of contract and related claims. BriteSmile denied the allegations of the complaint and filed an answer.

In May 2006, the parties entered into a settlement agreement, whereby BriteSmile paid Green River \$60,000 plus agreed to pay royalties on certain future revenues of the Company received from the QVC network until April 2008.

BriteSmile v. Oraceutical LLC, Oraceutical Innovative Properties LLC, and Eric Montgomery, filed in March 2006 in Utah state court. In its complaint, the Company asserted claims for breach of contract/specific performance, declaratory judgment, breach of fiduciary duty and punitive damages. These claims arose from the refusal of the defendants to sign documents confirming the assignment of certain patent rights to the Company as required under contracts with the Company.

In May 2006, the parties agreed to settle the litigation proceedings upon defendants' agreement to sign assignment documents satisfactory to the Company.

Gregg A. Coccari v. BriteSmile, Inc. commenced in August 2005 as an arbitration proceeding before the American Arbitration Association. In this proceeding, Coccari, the Company's former chief executive officer, asserted claims for breach of his employment contract with the Company, fraudulent inducement, negligent misrepresentation, violations of certain sections of the California Labor Code, tortious wrongful discharge in violation of public policy, and other state law claims relating to his alleged wrongful discharge by the Company. Coccari sought damages for alleged breaches of the termination and other provisions of the employment contract and under his state law claims, plus attorneys' fees and punitive damages. The Company denied Coccari's allegations and asserted counterclaims.

In September 2006, the parties settled the arbitration proceeding. Under the settlement, the Company agreed to pay Coccari \$700,000 (a portion of which was paid by the Company's insurance carrier) and that 160,000 of the 240,000 shares of the Company's common stock granted to Coccari in 2005 could be retained by Coccari. For his part, Coccari returned to the Company 80,000 shares of the Company's common stock and relinquished any rights to 600,000 options to purchase the Company's common stock. A liability equal to the value of this settlement has been accrued on the Company's September 30, 2006 balance sheet.

Mayer, Brown, Rowe & Maw LLP v. BriteSmile, Inc. and BriteSmile Development, Inc., filed in California state court (the "Mayer Brown Action"). Mayer, Brown, Rowe & Maw LLP ("MBR&M"), the Company's former counsel in the Discus Patent Litigation, filed a complaint alleging causes of action for breach of contract, breach of the implied covenant of good faith and fair dealing, and unjust enrichment arising from the attorney-client relationship between MBR&M and the Company. The Complaint alleged that MBR&M was entitled to more than \$12 million in attorney's fees allegedly due under the Contingent Fee Agreement entered into between MBR&M and the Company relating to the Discus Patent

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Litigation and other miscellaneous hourly fees. BriteSmile denied the allegations of MBR&M's complaint.

Concurrently with filing its Complaint, MBR&M filed an application for a right to attach order, a writ of attachment, and a temporary protective order attaching \$12,803,713 (the "MBR&M Application") of the proceeds obtained by the Company from its sale of the Associated Centers business to Discus. The Company opposed the MBR&M Application, but in April 2006, the court approved a writ of attachment on approximately \$6.5 million of the proceeds received by the Company from Discus from the sale of the Associated Centers business

In November 2006, the Company and MBR&M agreed in principle to settle the Mayer Brown Action. Under this agreement, the Company will pay MBR&M \$5 million in satisfaction of all of the claims in the Mayer Brown Action. The settlement proceeds will be paid from the \$6.5 million, held pursuant to the writ of attachment granted in April 2006, and has been fully accrued as a liability as of September 30, 2006.

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The following cases or claims remain active and pending against the  
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Company:  
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Smile Inc. Asia Pte. Ltd. v. BriteSmile filed in April 2002 in Utah state court. Smile Inc. Asia Pte. Ltd. ("Smile") sued the Company and BriteSmile Management, Inc., a wholly owned subsidiary of the Company ("BriteSmile Management") for \$10 million of claimed damages alleging that BriteSmile Management breached its 1998 distributor agreement with Smile (exclusive as to Singapore and other surrounding countries) for laser-aided teeth whitening devices by failing to fill orders 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, based on theories of breach of contract, conversion, unjust enrichment, civil conspiracy, breach of the duty of good faith and fair dealing, interference with contractual and economic relations, and fraudulent transfer. The trial court recently dismissed the claims for unjust enrichment and conversion.

In May 2002, the Company and BriteSmile Management filed their answer and counterclaim. The counterclaim alleges that Smile breached the distributor agreement by using BriteSmile's names and marks in a fashion not permitted by the distributor agreement and opposing the Company's efforts to register its marks in Singapore.

One of the principal defenses to Smile's claims is that the distributor agreement for the laser-aided teeth whitening devices 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 light activated teeth whitening or retail products and cannot claim damages for BriteSmile's marketing of such products in the exclusive territory described in the distributor agreement. Another important defense is that the market for laser-aided devices and procedures was rapidly shrinking during the relevant time period, which limits any potential damages claimed by Smile. The Company disputes liability and will continue to defend these claims. In December 2006 the court will conduct an evidentiary hearing regarding the reliability of Smile's expert witness testimony. The court has vacated the trial date, previously set for November 28, 2006.

On April 27, 2006, the court entered a prejudgment writ of attachment based



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on a stipulation of the parties whereby the court attached \$1.5 million of the approximate \$6.5 million that is currently subject to the writ of attachment issued in Mayer Brown litigation, as described above. In connection with the settlement of the Mayer Brown action, the Company will establish a separate account for the deposit of \$1.5 million for the prejudgment writ of attachment.

Claims of Oraceutical LLC, Oraceutical Innovative Properties LLC, and Eric Montgomery. In July 2003, Oraceutical LLC, Oraceutical Innovative Properties LLC, and Eric Montgomery (collectively, "Oraceutical") and the Company and BDI entered into an Asset Purchase Agreement (the "Purchase Agreement"). Pursuant to the Purchase Agreement, as subsequently amended in November 2003, BDI acquired intellectual property consisting primarily of certain United States and foreign patents, patent applications, continuations, continuations-in-part, trade secrets, technologies, know-how, trademarks and trade names relating to human oral care for a purchase price of \$6.4 million, plus a 50% participation interest in third party royalties and infringement recoveries relating to the intellectual property acquired. The intellectual property acquired from Oraceutical was sold to Discus in March 2006. Following the sale to Discus and the settlement of the Discus Patent Litigation, Oraceutical asserted various claims against the Company, including that under the terms of the Purchase Agreement it is entitled to a portion of the consideration paid by Discus. The Company has denied the claims of Oraceutical, but agreed to arbitrate Oraceutical's claims. No date for an arbitration proceeding has been set.

The Company is also subject to legal proceedings and claims in the ordinary course of business, including claims of alleged personal injury, infringement of trademarks and other intellectual property rights. However, the Company believes any such claims that have been presented to the Company as of the date of this report are without merit and the Company will vigorously defend against any such claims.

### 8. SUBSEQUENT EVENTS

On November 1, 2006, the Company changed its corporate legal name from BriteSmile, Inc. to BSML, Inc. This requirement to change the name of the Company arose in connection with the sale of the Associated Center business to Discus, which transaction is explained below. While the legal name of the corporate entity is changed, the Company will continue to do business as BriteSmile in respect of its whitening centers, its services and retail product branding, and its online marketing website.

On November 3, 2006, the Company announced that its CEO and President, John Reed, will leave the Company effective November 15, 2006. Mr. Reed will remain a director of the Company. Dr. Julian Feneley, presently a director of the Company, will re-join the Company on November 15, 2006 as its CEO and President.

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

### OVERVIEW

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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 this basis, the

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Company evaluates its estimates, including those related to customer programs and incentives, bad debts, inventories, income taxes, warranty obligations, financing operations, restructuring, 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.

BSML, Inc., and its affiliates, market and sell advanced teeth whitening products and services. Unless specified to the contrary herein, references to BSML 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's products and services are ultimately directed to consumers in the global marketplace for aesthetic enhancement. As such, general economic factors that affect consumer confidence and spending also affect the Company. The primary source of revenue for the Company is from consumers who are seeking to whiten their teeth using the most advanced technology available. This technology is offered through the Company's 17 Centers in 11 metropolitan areas in the U.S. The Company promotes demand for its products and services by advertising directly to the consumer, while also offering a range of whitening and post-whitening maintenance retail products that generate additional revenue.

Management of the Company focuses on optimizing the productivity of the existing Center locations, both in terms of the number of procedures performed per system and retail product revenue per procedure or venue. The marketing initiatives of the Company are usually constructed and monitored in such a way that management can determine their impact on revenue generation.

In addition, management seeks to leverage a cost base that includes, among other items, the cost of materials for the procedures and retail products, property and lease expenses, employee salaries and marketing expenses.

On March 13, 2006, the Company and certain of the its wholly owned subsidiaries completed an asset sale with Discus Dental, Inc., whereby Discus acquired the assets and operations of the Associated Centers business for approximately \$26.3 million plus the assumption of certain operating liabilities, and the Company settled its litigation with Discus for \$8.7 million, resulting in total consideration of approximately \$35 million to BSML.

On May 1, 2006, the Company gave notice to Dental Spas, LLC, an Iowa limited liability company ("Dental Spas"), that the Company was exercising its right to terminate the Limited Liability Company Membership Purchase Agreement (the "Purchase Agreement") dated January 13, 2006 between the Company and Dental Spas.

These financial statements reflected in this report have been prepared in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Accordingly, as a result of the events in 2006, the results of operations for the Centers have been presented as continuing operations for all periods presented and the results of operations of the Associated Centers for all periods presented have been presented as discontinued operations. All assets and liabilities related to discontinued operations are classified as held for sale for all comparative reporting periods presented. The continuing operations in the financial statements consist of the results of the Centers business and the BSML corporate entity.

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### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, which require the Company to make estimates and assumptions. The Company believes that the following critical accounting policies require significant management judgments, estimates and assumptions in the preparation of the consolidated financial statements.

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#### Revenue Recognition

BSML recognizes revenue related to retail products at the time such products are sold or shipped 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 its Smile Forever touch up program over the specified maintenance period for the program (currently a maximum of 4 touch-ups over the following two years). The amount of revenue deferred related to the Smile Forever sales depends upon the particular sale circumstances - for example if the program was discounted as part of a bundle promotion or as a complementary offering to the purchase of a whitening procedure, consistent with EITF-0021 and FAS 104. In the case of bundled promotion sales including Smile Forever, the Smile forever revenue is deferred based on the allocation of the fair market values of all of the elements in each promotional type of transaction.

#### Deferred Contract Costs

During 1999, the Company granted warrants to Orthodontic Centers of America ("OCA") in consideration of OCA installing the Company's BS3000 machines in OCA centers. The value of the warrants was capitalized as deferred contract costs and was being amortized as a reduction of revenue over the life of the agreement (approximately 10 years). The unamortized balance of \$268,000 is included in "assets held for sale" on the balance sheet at December 31, 2005 and is not reflected on the September 30, 2006 balance sheet as this deferred contract cost was written-off upon the sale of the Associated Centers business to Discus in March 2006.

During 2003, the Company introduced the Magic Mirror, a marketing product designed to show potential customers what their teeth will look like after an LATW procedure. The Company provided the Magic Mirror to Associated Centers under five-year contracts 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 were capitalized and are being amortized to revenue and cost of goods sold over the life of the contract. In the event a particular Associated Center abandoned the contract or failed to order any procedures for six months, the remaining capitalized cost of the Magic Mirror was written off. At December 31, 2005, the capitalized amount included in "assets held for sale" on the balance sheet was \$463,000, net of deferred revenue received from the sale of Magic Mirrors to customers. Deferred Magic Mirror cost is not reflected on the September 30, 2006 balance sheet as it was written-off upon the sale of the Associated Centers business to Discus in March 2006.

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### Inventories

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

### Property, Equipment and Improvements

BSML evaluates its property, equipment and improvements for impairment whenever indicators of impairment exist. No material impairment charge was recorded in either the 39 weeks period ended September 30, 2006 or September 24, 2005.

### Valuation of Financial Instruments Related to Convertible Debt

In December 2004, BSML sold to six investors in a private placement \$12 million of Convertible Debt that was to be repaid over 36 months beginning in June 2006 in cash or registered stock. The Convertible Debt was convertible into common shares of the Company at a conversion price of \$7.61 per share, which is 115% of the volume-weighted average price of the common stock during the 10-day period prior to the transaction date (the "Financial Instruments Related to Convertible Debt - Conversion Option"). In addition, the investors were issued five-year warrants to purchase 544,253 shares of common stock at an exercise price of \$7.61 per share (the "Financial Instruments Related to Convertible Debt - Warrants"). The investors also had an additional investment right that gives the investors the option within 180 trading days to loan the Company up to an additional \$4 million under the same terms (the "Financial Instruments Related to Convertible Debt - AIR"). The Financial Instruments Related to Convertible Debt - Conversion Option, the Financial Instruments Related to Convertible Debt - Warrants and the Financial Instruments Related to Convertible Debt - AIR together are the "Financial Instruments Related to Convertible Debt." In connection with the December 2004 financing, the Company filed a registration statement with the Securities and Exchange Commission (the "SEC") in January 2005 to cover the underlying shares for the transaction. The SEC declared the registration statement effective in February 2005.

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The Company allocated the net proceeds from the sale of the Convertible Debt between the Convertible Debt, the Financial Instruments Related to Convertible Debt - Warrants, and the Financial Instruments Related to Convertible Debt - AIR based on their relative fair values. The Company employed the Black-Scholes model to value the embedded conversion option of the Convertible Debt. The relative fair values of the Financial Instruments Related to Convertible Debt - Warrants and the Financial Instruments Related to Convertible Debt - AIR, and the fair value of the embedded conversion option resulted in the recording of a discount on the Convertible Debt.

In accordance with APB No. 14, The Company accounted for the Financial Instruments Related to Convertible Debt - Warrants separately as freestanding instruments. The value of the Financial Instruments Related to Convertible Debt - Warrants was determined utilizing the Black-Scholes option pricing model, which was consistent with the Company's historical valuation methods. The following assumptions and estimates were used in the Black-Scholes model: volatility of 0.600; an average risk-free interest rate of 3.50%; dividend yield of 0%; and an expected life of 4.42 years. The value of the Financial Instrument Related to Convertible Debt - Warrants was treated as a liability and marked-to-market based on the current stock price with the resulting gain or

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loss reflected in the income statement. As of February 4, 2005, the Company's registration statement relating to the warrants was declared effective which triggered the financial instrument to convert to equity. The value of the Financial Instrument Related to Convertible Debt - Warrants as of the date of conversion was \$1.2 million.

In accordance with APB No. 14, the Company accounted for the Financial Instruments Related to Convertible Debt - Additional Investment Rights separately as freestanding instruments. The value of the Financial Instruments Related to Convertible Debt - Additional Investment Rights was determined utilizing the Black-Scholes option pricing model, which is consistent with the Company's historical valuation methods. The following assumptions and estimates were used in the Black-Scholes model: volatility of 0.600; an average risk-free interest rate of 3.50%; dividend yield of 0%; and an expected life of 0.75 years. The value of the Financial Instruments Related to Convertible Debt - Additional Investment Rights has been recorded as a current liability and was marked-to-market based on the current stock price with the resulting gain or loss reflected in the income statement. As of September 4, 2005, the Additional Investment Rights expired; the value of the financial instruments was written off.

In accordance with SFAS No. 133 the Company has accounted for the Financial Instruments Related to Convertible Debt - Conversion Option as a freestanding instrument. The value of the Financial Instruments Related to Convertible Debt - Conversion Option was determined utilizing the Black-Scholes option pricing model, which is consistent with the Company's historical valuation methods. The following assumptions and estimates were used in the Black-Scholes model: volatility of 0.600; an average risk-free interest rate of 3.50%; dividend yield of 0%; and an average expected life of 2.88 years. The value of the Financial Instruments Related to Convertible Debt - Conversion Option has been recorded as a long-term liability and was marked to market on December 31, 2005. The value of the Financial Instruments Related to Convertible Debt - Conversion Option as of December 31, 2005 was \$9,205. The only change to the assumptions and estimates used in the model was a reduction to the average expected life of one year.

The discount on the Convertible Debt was being amortized to interest expense over the life of the Convertible Debt using the effective yield method. The Convertible Debt accrued interest at the greater of 5% or 6-month LIBOR plus 300 basis points (capped at 8%) payable in cash or registered stock. Interest was payable quarterly in arrears.

The convertible debt was paid in full at the principal amount of \$12.0 million, plus accrued interest, in March 2006, and all noteholder warrants related to this debt were cancelled at that time. The remaining unamortized discount was \$4.6 million as of December 31, 2005, and was \$4.1 million on March 13, 2006, the day the convertible debt was paid off, which was written off at the time of debt repayment as a loss on the early extinguishment of debt in the condensed consolidated statement of operations for the 13-week period ended April 1, 2006.

### Center Closures

The Company has recorded reserves in connection with Center closures. These reserves, which are periodically adjusted, 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 closures may differ from these estimates.

### Sales Tax Liability

Through the date of this report, certain states have issued initial

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assessments against the Company claiming insufficient remittance of sales taxes on revenues from past procedure sales to Associated Centers, which the Company is disputing. Based upon the result of settlement of sales tax audits as well as the circumstances and advice of its independent advisors on the matters that are still pending, management has estimated and accrued approximately \$2.1 million as of September 30, 2006 for potential additional sales tax liability related to these assessments and related state sales tax matters.

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In the third quarter of 2006, the Company achieved settlement agreements on assessments by both New York State and Texas. The Company's reported quarter-end sales tax liability balance of \$2.1 million reflects, among other matters, the remaining balance owed to New York., while the Texas settlement has been paid in full during the quarter.

The Company may further increase its tax accrual in the future in response to outstanding sales tax audits or potential future audits and/or assessments. The Company intends to vigorously challenge the imposition of any new tax assessments if and when they arise, and believes it has substantial authority for its position. Nonetheless, the Company may attempt to negotiate a resolution of such potential assessments and may also initiate discussions with some other states that have not asserted additional assessments against the Company. An unfavorable outcome with respect to these sales tax matters could have a material adverse affect on the Company's financial position and results of operations, and no assurance can be given that these tax matters will be resolved in the Company's favor in view of the inherent uncertainties involved in tax proceedings. The Company believes that it has provided adequate accruals for additional taxes and related interest expense that may ultimately result from sales tax audits , and will re-evaluate the adequacy of its reserves as new information or circumstances warrant.

### FORWARD LOOKING STATEMENTS

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 filings with the SEC, is 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 those risks set forth under "Item 1A. Risk Factors".

### RESULTS OF OPERATIONS

THE FOLLOWING ARE EXPLANATIONS OF SIGNIFICANT CHANGES FOR THE 13-WEEKS

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PERIOD ENDED SEPTEMBER 30, 2006 COMPARED TO THE 13-WEEKS PERIOD ENDED SEPTEMBER 24, 2005:

TOTAL REVENUES, NET increased 30% from \$5.2 million for 2005 to \$6.7 million in 2006. The increase was primarily due to Center whitening fee revenues increasing 38% from \$ 4.2 million for 2005 to \$ 5.8 million in 2006. The increase is due to two primary factors: 1) higher volume from a decrease in the procedure price in April 2006 to \$399; and 2) with the Associated Center ("AC") business sold, calls to the call center were directed 100% to BSML spas instead of a portion going to the AC dentists. Product and other revenue decreased 3% from \$972,000 for 2005 to \$943,000 in 2006. This reduction was primarily due to higher revenue deferral related to Smile Forever program promotions (approx. \$1.0 million), offset by an increase of approximately \$670,000 in retail product sales through the QVC television network channel and our Centers, and by a reduction in prepaid deferred revenue liability (approx. \$295,000).

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES increased from \$ 3.7 million for the third quarter of 2005 to \$8.7 million in the third quarter of 2006. The increase was primarily due to a net increase of approximately \$5.0 million in legal expense and reserves related to on-going litigation.

RESEARCH AND DEVELOPMENT EXPENSES decreased from \$266,000 in 2005 to \$45,000 in 2006. The Company performed minimal research activities since the sale of its AC business..

DEPRECIATION AND AMORTIZATION expense decreased 37%, from \$ 660,000 in 2005 to \$ 415,000 in 2006. This decrease was primarily due to the depreciating Center assets reaching the end of their depreciable lives in certain Centers over the course of the last year.

GAIN ON MARK-TO-MARKET OF CONVERTIBLE NOTE INSTRUMENTS. To reflect the fair value in each reporting period, the Financial Instruments Related to Convertible Debt was revalued and marked-to-market based on the then stock price with the resulting gain or loss reflected in the income statement. The total mark-to-market adjustments on convertible note instruments in the third quarter of 2005 resulted in a gain of approximately \$1.2 million. No gain or loss occurred in the third quarter of 2006 as the convertible debt was paid off in first quarter 2006.

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AMORTIZATION OF DISCOUNT ON CONVERTIBLE DEBT. The convertible debt issued in December 2004 was valued net of discount. That discount was being amortized over the life of the debt using the effective interest method up until the date the debt was paid in March 2006. For the 13-week period ended September 24, 2005, the Company recorded \$652,000 of amortization. The unamortized debt discount remaining when the debt was paid off in March 2006 has been recorded as a loss on the early extinguishment of debt (\$5.0 million). For the 13-week period ended September 30, 2006, there was no amortization of discount on convertible debt, as the debt had been repaid.

OTHER INCOME AND EXPENSE, NET. For the 13 -week end September 30, 2006 other income net of expenses, was \$185,000 and was composed primarily of interest earned. As all debt was repaid in March 2006, we did not have any interest expense in this period. For the comparable period in 2005, we had net expense of \$251,000 and this was mostly composed of interests expense.

THE FOLLOWING ARE EXPLANATIONS OF SIGNIFICANT CHANGES FOR THE 39-WEEK PERIOD ENDED SEPTEMBER 30, 2006 COMPARED TO THE 39-WEEK PERIOD ENDED SEPTEMBER 24, 2005:

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TOTAL REVENUES, NET increased 32% from \$15.6 million for 2005 to \$20.5 million in 2006. The Center whitening fee revenues increased 30% from \$ 12.8 million for 2005 to \$ 16.7 million in 2006. Product and other revenue increased 36% from \$ 2.8 million for 2005 to \$ 3.8 million in 2006. The reported revenue level for 2006 was also impacted by the revenue deferral related to the free Smile Forever promotion in the third quarter.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES increased 55% from \$ 11.7 million for 2005 to \$18.1 million in 2006. The primary reason for this increase is legal expense related to litigation matters, as well as severance and lease buyout costs associated with the restructuring of the Company after the sale of the AC business.

RESEARCH AND DEVELOPMENT EXPENSES decreased from \$607,000 for 2005 to \$135,000 in 2006. The Company performed minimal research activities during its efforts to sell its business and after the sale of the AC business.

DEPRECIATION AND AMORTIZATION expense decreased approximately \$600,000, from \$ 1.8 million in 2005 to \$ 1.2 million in 2006. A part of the decrease is a result of reaching the end of the depreciable lives of certain assets.

GAIN ON MARK-TO-MARKET OF FINANCIAL INSTRUMENTS RELATED TO CONVERTIBLE DEBT. To reflect the fair value in each reporting period, the Financial Instruments Related to Convertible Debt was revalued and marked-to-market based on the then stock price with the resulting gain or loss reflected in the income statement. The total mark-to-market adjustments in the first three quarters of 2005 resulted in a gain of \$3.8 million. No gain or loss was recognized in the first three quarter of 2006 as the convertible debt was paid off in March 2006.

AMORTIZATION OF DISCOUNT ON CONVERTIBLE DEBT. The convertible debt issued in December 2004 was valued net of discount. That discount was being amortized over the life of the debt using the effective interest method up until the date the debt was paid in March 2006. For the 39-week period ended September 30, 2006, the Company recorded \$530,000 of amortization. The debt was outstanding the full 39 weeks of 2005, when we recorded \$1.9 million of amortization. The unamortized debt discount remaining when the debt was paid off in March 2006 has been recorded as a loss on the early extinguishment of debt (\$5.0 million). There was no comparable extinguishment of debt for the 39-week period ended September 24, 2005.

OTHER INCOME AND EXPENSE, NET. For the 39 weeks ended September 30, 2006, other income and expenses, was net expense of \$660,000. The principal component was cost of \$870,000 related to the termination of the agreement to sell the Center business. For the comparable period in 2005, we reflect net expense of \$976,000 due mostly to net interest expense on debt.

### LIQUIDITY AND CAPITAL RESOURCES

#### GENERAL

The Company's principal sources of liquidity have been proceeds from issuances of common stock and debt, as well as, most recently, the proceeds from the sale of the AC business in March, 2006. At September 30, 2006, the Company had \$5.7 million in unrestricted cash. To date, the Company has yet to achieve bottom-line profitability on a sustained basis. The Company expects that its principal uses of cash will be to provide working capital to meet corporate expenses and satisfy outstanding liabilities, and if and when decided, to open new whitening centers.



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Proceeds received from the sale of the Associated Centers business on March 13, 2006 have been used or are reserved to be used in the foreseeable future to pay off long-term debt, capital leases and accrued interest, (\$19.4 million); to establish an escrow account from which payment can be made for claims BSML has agreed to indemnify Discus, (\$3.5 million remaining in escrow as of September 30, 2006); to pay costs associated with the asset sale transaction, (\$1.0 million); to pay outstanding legal bills related to the Discus patent litigation, (\$5 million); to pay employee severance, (\$1.2 million through July 1, 2006); to resolve certain outstanding sales tax issues related to the Associated Centers, (at least \$2 million); and to pay potential income and other tax related to the Discus transaction, (\$1.0 million). Any remaining proceeds will be used for working capital needs.

The financial statements reflect a going concern basis of accounting. While the Company currently is able to pay its debts as they come due, and has a plan to generate positive cash flow from its Centers business operations, it is not certain that the Company will achieve bottom-line profitability on a sustained basis, especially in light of the continuing legal fees associated with the Company's litigation. In addition, a legal ruling restricted the use of \$6.5 million of the Company's cash in connection with the on going litigation with Mayer, Brown, Rowe & Maw LLP. This amount is included in "Investments, restricted as to use" on the balance sheet. Furthermore, the Company has agreed to a standby \$1.5 million writ of attachment in connection with the Smile, Inc. litigation. The Mayer Brown cash restriction and any other further cash restriction could have a significant adverse impact on the Company's ability to fund operations in the near term. In addition, it is possible that the Company could have additional cash demands as a result of the legal claims against the Company. The liquidity projections may improve or deteriorate depending on these changing conditions.

### Cash Requirements

During the last three years, the primary uses of cash were for funding of operations, opening new whitening centers, purchase of equipment and debt repayments. Some of the proceeds realized from selling the Associated Centers business in March 2006 were used to pay all outstanding debt. Therefore, in the near term, the primary use of cash is expected to be to support the Centers business and related corporate overhead expenses as well as the liquidation of litigation, tax, and other outstanding liabilities.

The Company has the following contractual obligations as of September 30, 2006:

CONTRACTUAL OBLIGATIONS	PAYMENTS DUE BY PERIOD (IN THOUSANDS)			
	TOTAL	LESS THAN 1 YEAR	1-3 YEARS	4-5 YEARS
Operating Leases.....	\$ 13,507	\$ 3,720	\$ 7,297	\$ 1,724
Service Contracts.....	\$ 488	\$ 248	\$ 240	--
Total Contractual Cash Obligations.....	\$ 13,995	\$ 3,968	\$ 7,537	\$ 1,724

### SOURCES OF CASH, LIQUIDITY AND CAPITAL RESOURCES

In the 39 weeks ended September 30, 2006, net cash provided by operations was

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\$2.2 million.

Cash provided from investing activities was \$17.1 million. The Company had no material capital expenditures in the third quarter of 2006.

Net cash used in financing activities was \$(19.1) million for the 39 weeks ended September 30, 2006.

### ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURE ABOUT MARKET RISK

We believe there has been no material change in the Company's exposure to Market Risk from that discussed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

### ITEM 4. CONTROLS AND PROCEDURES

Company management is aware of certain deficiencies in the design or operation of the Company's disclosure controls and internal accounting controls.

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In connection with its audit of the Company's 2004 financial statements, Deloitte & Touche LLP, the Company's former independent registered public accounting firm reported that (1) inadequacies in the design and execution of the Company's internal control structure, and (2) improper application of accounting principles in accordance with GAAP, constituted material weaknesses in the Company's internal control structure for the year ended December 31, 2004. During 2005, the Company worked to improve its controls and reporting processes. These efforts included, among other actions, the engagement of outside consultants to identify solutions to control weaknesses and implement corrective actions, clear assignment of account responsibilities among the finance staff, more disciplined deployment of accounting close activities and requirements, along with additional oversight and review of accounting entries by finance management. As a result of these efforts, there has been improvement in the internal controls and reporting processes. In the course of the 2005 audit, there were relatively few adjusting entries required to finalize the Company's financial statements. The Company believes that all required adjustments have been made and are properly incorporated in the reported results of the Company for the year ended 2005. These efforts have continued during the first three quarters of 2006 and the Company believes that all required adjustments were made and properly incorporated in the reported results of the Company for the period ended September 30, 2006.

The Company's management, with the participation of its Principal Executive Officer and 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. During the course of the evaluation, the additional procedures performed and controls instituted by the Company to enhance its internal controls and mitigate the effect of deficiencies and to prevent misstatements or omissions in its consolidated financial statements were considered. However, since the Company was in the process of selling its businesses during the first five months of 2006, there was a significant amount of its finance resources shifted to the sale of its businesses, with less emphasis on continued future process improvements. As a result of the decision to sell its operations, there was also a significant amount of turnover among the finance staff in the first two quarters of 2006. As a result of these factors, the Company's Principal Executive Officer and Chief Financial Officer have concluded that, while the Company's disclosure controls and procedures have improved in the third quarter 2006, they are not yet effective as of the period covered by this report.

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However, since the Company has decided recently to continue in the Centers business, Finance management has begun to stabilize its staffing by hiring a Director of Finance and an accountant, and to re-focus its efforts on its controls and reporting processes going forward. The Company has begun to make improvements to its policies, procedures, systems and staff who have significant roles in disclosure controls and in internal controls over financial reporting, and will continue these efforts during the remainder of 2006 with a goal of addressing any remaining deficiencies.

There were no significant changes in internal controls during the last fiscal quarter, other than those referenced above that have materially affected internal control over financial reporting.

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### PART II - OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

The Company is the subject of certain legal actions. Management believes that it has accrued the appropriate amount of liability for actions against the Company. 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 BSML's strategies related to these legal actions.

The following matters pending on December 31, 2005 or commenced thereafter,  
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have been settled:  
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BSML, Inc. v. Discus Dental, Inc. and Salim Nathoo, filed in federal court in California (the "Discus Patent Litigation"). This case was dismissed with prejudice in March 2006. The Company filed a complaint against Discus Dental, Inc. ("Discus") in July 2002, and added Salim Nathoo ("Nathoo") as a defendant in February 2003. As subsequently amended, the complaint asserted claims of patent infringement, misappropriation of the Company's trade secrets, civil conspiracy, and unfair competition and business practices by Discus and Nathoo jointly and other claims against Discus and Nathoo, individually. Discus filed counterclaims seeking declarations of invalidity and non-infringement of several BriteSmile patents, and for other claims.

On March 13, 2006, the parties settled all litigation proceedings between them, including the Discus Patent Litigation and the litigation described in the two following paragraphs. Discus and the Company agreed to settle the Discus Patent Litigation and the litigation described in the following two paragraphs for consideration to the Company of \$8.7 million.

BriteSmile Development, Inc. v. Discus Dental, Inc. BriteSmile Development, Inc. ("BDI"), a wholly owned subsidiary of BSML, Inc. filed in October 2005, a patent infringement suit against Discus in federal court in California. The suit alleged that Discus' Zoom! 2 tooth whitening system infringed a patent issued to BDI in October 2005. This case was dismissed in March 2006, as described above.

BriteSmile v. Discus Dental, Inc., filed in May 2002 in California state court. The Company filed a complaint against Discus alleging state law causes of action for intentional interference with contractual relationship, negligent interference with contractual relationship, unfair business practices and related claims. This case was dismissed in March 2006, as described above.

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The Procter & Gamble Company v. Oraceutical LLC, IDEX Dental Sciences, Inc., Robert Eric Montgomery, BriteSmile, Inc. and BriteSmile Development, Inc., filed in June 2003 in federal court in Ohio. This case was dismissed in February 2006 in connection with a settlement payment from the Procter & Gamble Company ("P&G"). In its complaint P&G alleged 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 in May 2003. Montgomery is a former director of the Company, and Oraceutical LLC, which is owned by Montgomery, is a consultant to the Company. The complaint also sought a declaratory judgment that certain U.S. patents previously owned by the Company (but owned by the REM Group at the time the complaint was filed) (the "Patents") were invalid and unenforceable, and that P&G's Whitestrips product did not infringe the Patents. In February 2004, the defendants filed an answer and counterclaims.

In February 2006 the parties settled the litigation proceedings between them. As part of the settlement, the Company granted to P&G a nonexclusive license to certain patents relating to teeth whitening strips and P&G agreed to pay \$4 million. The Company recorded a gain of approximately \$1.3 million from its portion of the settlement proceeds.

Green River Junction v. BriteSmile, filed in November 2005, in Pennsylvania state court. In its complaint Green River Junction, Inc. ("Green River") sought to recover approximately \$85,000 from the Company on breach of contract and related claims. BriteSmile denied the allegations of the complaint and filed an answer.

In May 2006, the parties entered into a settlement agreement, whereby BriteSmile paid Green River \$60,000 plus agreed to pay royalties on certain future revenues of the Company received from the QVC network until April 2008.

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BriteSmile v. Oraceutical LLC, Oraceutical Innovative Properties LLC, and Eric Montgomery, filed in March 2006 in Utah state court. In its complaint, the Company asserted claims for breach of contract/specific performance, declaratory judgment, breach of fiduciary duty and punitive damages. These claims arose from the refusal of the defendants to sign documents confirming the assignment of certain patent rights to the Company as required under contracts with the Company.

In May 2006, the parties agreed to settle the litigation proceedings upon defendants' agreement to sign assignment documents satisfactory to the Company.

Gregg A. Coccari v. BriteSmile, Inc. commenced in August 2005 as an arbitration proceeding before the American Arbitration Association. In this proceeding, Coccari, the Company's former chief executive officer, asserted claims for breach of his employment contract with the Company, fraudulent inducement, negligent misrepresentation, violations of certain sections of the California Labor Code, tortious wrongful discharge in violation of public policy, and other state law claims relating to his alleged wrongful discharge by the Company. Coccari sought damages for alleged breaches of the termination and other provisions of the employment contract and under his state law claims, plus attorneys' fees and punitive damages. The Company denied Coccari's allegations and asserted counterclaims.

In September 2006, the parties settled the arbitration proceeding. Under the settlement, the Company agreed to pay Coccari \$700,000 (a portion of which was paid by the Company's insurance carrier) and that 160,000 of the 240,000 shares of the Company's common stock granted to Coccari in 2005 could be

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retained by Coccari. For his part, Coccari returned to the Company 80,000 shares of the Company's common stock and relinquished any rights to 600,000 options to purchase the Company's common stock. A liability equal to the value of this settlement has been accrued on the Company's September 30, 2006 balance sheet.

Mayer, Brown, Rowe & Maw LLP v. BriteSmile, Inc. and BriteSmile Development, Inc., filed in California state court (the "Mayer Brown Action"). Mayer, Brown, Rowe & Maw LLP ("MBR&M"), the Company's former counsel in the Discus Patent Litigation, filed a complaint alleging causes of action for breach of contract, breach of the implied covenant of good faith and fair dealing, and unjust enrichment arising from the attorney-client relationship between MBR&M and the Company. The Complaint alleged that MBR&M was entitled to more than \$12 million in attorney's fees allegedly due under the Contingent Fee Agreement entered into between MBR&M and the Company relating to the Discus Patent Litigation and other miscellaneous hourly fees. BriteSmile denied the allegations of MBR&M's complaint.

Concurrently with filing its Complaint, MBR&M filed an application for a right to attach order, a writ of attachment, and a temporary protective order attaching \$12,803,713 (the "MBR&M Application") of the proceeds obtained by the Company from its sale of the Associated Centers business to Discus. The Company opposed the MBR&M Application, but in April 2006, the court approved a writ of attachment on approximately \$6.5 million of the proceeds received by the Company from Discus from the sale of the Associated Centers business

In November 2006, the Company and MBR&M agreed in principle to settle the Mayer Brown Action. Under this agreement, the Company will pay MBR&M \$5 million in satisfaction of all of the claims in the Mayer Brown Action. The settlement proceeds will be paid from the \$6.5 million, held pursuant to the writ of attachment granted in April 2006 and has been fully accrued as a liability as of September 30, 2006.

The following cases or claims remain active and pending against the

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Company:  
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Smile Inc. Asia Pte. Ltd. v. BriteSmile filed in April 2002 in Utah state court. Smile Inc. Asia Pte. Ltd. ("Smile") sued the Company and BriteSmile Management, Inc., a wholly owned subsidiary of the Company ("BriteSmile Management") for \$10 million of claimed damages alleging that BriteSmile Management breached its 1998 distributor agreement with Smile (exclusive as to Singapore and other surrounding countries) for laser-aided teeth whitening devices by failing to fill orders 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, based on theories of breach of contract, conversion, unjust enrichment, civil conspiracy, breach of the duty of good faith and fair dealing, interference with contractual and economic relations, and fraudulent transfer. The trial court recently dismissed the claims for unjust enrichment and conversion.

In May 2002, the Company and BriteSmile Management filed their answer and counterclaim. The counterclaim alleges that Smile breached the distributor agreement by using BriteSmile's names and marks in a fashion not permitted by the distributor agreement and opposing the Company's efforts to register its marks in Singapore.

One of the principal defenses to Smile's claims is that the distributor

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agreement for the laser-aided teeth whitening devices 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 light activated teeth whitening or retail products and cannot claim damages for BriteSmile's marketing of such products in the exclusive territory described in the distributor agreement. Another important defense is that the market for laser-aided devices and procedures was rapidly shrinking during the relevant time period, which limits any potential damages claimed by Smile. The Company disputes liability and will continue to defend these claims. In December 2006 the court will conduct an evidentiary hearing regarding the reliability of Smile's expert witness testimony. The court has vacated the trial date, previously set for November 28, 2006.

On April 27, 2006, the court entered a prejudgment writ of attachment based on a stipulation of the parties whereby the court attached \$1.5 million of the approximate \$6.5 million that is currently subject to the writ of attachment issued in Mayer Brown litigation, as described above. In connection with the settlement of the Mayer Brown action, the Company will establish a separate account for the deposit of \$1.5 million for the prejudgment writ of attachment.

Claims of Oraceutical LLC, Oraceutical Innovative Properties LLC, and Eric Montgomery. In July 2003, Oraceutical LLC, Oraceutical Innovative Properties LLC, and Eric Montgomery (collectively, "Oraceutical") and the Company and BDI entered into an Asset Purchase Agreement (the "Purchase Agreement"). Pursuant to the Purchase Agreement, as subsequently amended in November 2003, BDI acquired intellectual property consisting primarily of certain United States and foreign patents, patent applications, continuations, continuations-in-part, trade secrets, technologies, know-how, trademarks and trade names relating to human oral care for a purchase price of \$6.4 million, plus a 50% participation interest in third party royalties and infringement recoveries relating to the intellectual property acquired. The intellectual property acquired from Oraceutical was sold to Discus in March 2006. Following the sale to Discus and the settlement of the Discus Patent Litigation, Oraceutical asserted various claims against the Company, including that under the terms of the Purchase Agreement it is entitled to a portion of the consideration paid by Discus. The Company has denied the claims of Oraceutical, but agreed to arbitrate Oraceutical's claims. No date for an arbitration proceeding has been set.

The Company is also subject to legal proceedings and claims in the ordinary course of business, including claims of alleged personal injury, infringement of trademarks and other intellectual property rights. However, the Company believes any such claims that have been presented to the Company as of the date of this report are without merit and the Company will vigorously defend against any such claims.

### ITEM 1A. RISK FACTORS

#### FORWARD-LOOKING STATEMENTS AND RISK FACTORS

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The following risk factors and other information included in this Report should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair business operations. The following risks could materially adversely affect the business, financial conditions, operating results and cash flows.

#### THE ASSET PURCHASE AGREEMENT WITH DISCUS EXPOSES US TO CONTINGENT LIABILITIES.

In connection with the sale of the Associated business to Discus, the Company agreed to indemnify Discus for a number of matters, including the breach

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of our representations, warranties and covenants contained in the Asset Purchase Agreement with Discus, as well as any potential additional local sales, stamp, or VAT tax obligations. A breach or inaccuracy of any of the representations, warranties and covenants in the Asset Purchase Agreement could lead to an indemnification claim against us by Discus. Any such indemnification claims could require us to pay substantial sums and incur related costs and expenses and have a material adverse effect on our liquidity, financial condition, future prospects and ability to continue the operations of the spas. An escrow account was established for \$3.5 million from the Associated Centers' sale proceeds from which any payments due Discus resulting from a breach of our representations, warranties and covenants would be paid.

OUR ABILITY TO UTILIZE OUR NET OPERATING LOSS CARRYFORWARD MAY BE LIMITED OR ELIMINATED IN ITS ENTIRETY.

We will recognize gains for federal income tax purposes on the sale of the assets in the sale of our Associated Centers business. We have a substantial net operating loss carryforward that we plan to use to offset our federal tax liability to the extent allowable, other than alternative minimum tax, generated from the sale of our Associated Centers business. Based on the final determination of the purchase price allocation of the Associated Centers business, we may be subject to additional tax in the Republic of Ireland above the federal income tax.

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If our net operating loss carryforward is found to be subject to annual limitations, then our federal tax liability and available cash proceeds after the sale may be materially different and our financial position could be adversely affected. As of December 2005, we had net operating loss carryforwards of approximately \$155 million that we anticipate may be used in the future to reduce our federal tax liability. We established a full valuation allowance against the net operating loss carryforward, along with all other deferred tax assets, to reflect the uncertainty of the recoverability of this asset. The utilization of this asset in the future is dependent upon our having positive earnings. Furthermore, the likelihood of an annual limitation on our ability to utilize our net operating loss carryforward to offset future U.S. federal taxable income is increased by (1) the issuance of certain convertible preferred stock, options, warrants, or other securities exercisable for common stock, (2) changes in our equity ownership occurring in the last three years and (3) potential future changes in our equity ownership. The amount of an annual limitation can vary significantly based on factors existing at the date of an ownership change. If such limitations were imposed, they could have a material adverse impact on our results of operations and cash flows.

WE FACE POSSIBLE DELISTING FROM THE NASDAQ SMALLCAP MARKET, WHICH WOULD RESULT IN A LIMITED PUBLIC MARKET FOR OUR COMMON STOCK, AND MAY ADVERSELY AFFECT THE PRICE AND TRADING VOLUME OF OUR COMMON STOCK.

There are several requirements for the continued listing of our common stock on the Nasdaq SmallCap Market, including, but not limited to, maintaining a minimum bid price of \$1.00 per share, maintaining total shareholders' equity of \$2.5 million and maintaining an operating business.

At various times in the past, we were not in compliance with one or more of the foregoing requirements, and received notices from Nasdaq to that effect. While we believe that we currently are in compliance with Nasdaq's continued listing requirements, we cannot guaranty that we will continue to be in compliance in the future. If we fail to comply with Nasdaq's continued listing requirements, our common stock may be delisted from Nasdaq.

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If our common stock is delisted, trading our stock may become more difficult and our stock price could decrease. If our common stock is not listed on the Nasdaq SmallCap Market, many potential investors will not purchase it, which would further limit the trading market for our common stock.

OUR STOCK PRICE MAY BE VOLATILE AND YOU COULD LOSE ALL OR PART OF YOUR INVESTMENT.

We expect that the market price of our common stock will be volatile. Stock prices have risen and fallen in response to a variety of factors, including:

- o quarter-to-quarter variations in operating results; and
- o market conditions in the economy as a whole.

The market price for our common stock may also be affected by our ability to meet investors' or securities analysts' expectations. Any failure to meet these expectations, even slightly, may result in a decline in the market price of our common stock. In addition, the stock market is subject to extreme price and volume fluctuations. This volatility has had a significant effect on the market prices of securities issued by many companies for reasons unrelated to the operating performance of these companies. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against that company. If similar litigation were instituted against us, it could result in substantial costs and a diversion of our management's attention and resources.

WE HAVE A HISTORY OF LOSSES AND ACCUMULATED DEFICIT AND THIS TREND OF LOSSES MAY CONTINUE IN THE FUTURE.

For 2005, 2004 and 2003, we had a net loss of \$17.8 million, \$7.8 million and \$14.6 million, respectively. As of December 31, 2005, our accumulated deficit was \$175.8 million. We sold our Associated Centers business in the first quarter of 2006, and our Centers business is our sole operating business. We currently intend to continue to operate our Centers business. We have not been able to operate profitably in the past, and while our business currently consists of only our Centers business and not our Associated Centers business, which we sold, we cannot guarantee that our business will be profitable on a sustained basis.

### INFLATION

Most of our products are purchased in finished form and packaged by the supplier. We anticipate usual inflationary increases in the price of our products and do not intend to pass these increases along to our customers. In general, we do not believe that inflation has had a material effect on our results of operations in recent years. However, there can be no assurance that our business will not be affected by inflation in the future.

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### SEASONALITY

We believe that our business follows seasonal trends due to increased consumer demand during certain seasons and around public and national holidays. As a result, our sales performance could potentially be affected.

OUR SUCCESS WILL DEPEND ON ACCEPTANCE OF OUR LATW PROCESS AND POST-WHITENING MAINTENANCE PRODUCTS.

We derive most of our revenues from our LATW procedures, one of many



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teeth-whitening solutions offered to consumers. We also market BriteSmile branded toothpaste, electric toothbrushes, mouthwash, the BriteSmile-to-Go pen, and post-whitening procedure touchups through our Centers and on our website. Our success will depend in large part on our ability to successfully encourage consumers to switch from traditional and less expensive bleaching tray whitening methods to our LATW system, and on our ability to successfully market our line of whitening and post-whitening maintenance products. There can be no assurance that consumers will accept our procedure or products. Typically, medical and dental insurance policies do not cover teeth whitening procedures, including the Company's LATW procedure, or whitening maintenance products, which may have an adverse impact upon the market acceptance of our products and services.

OUR SUCCESS WILL DEPEND ON OUR ABILITY TO UPDATE OUR TECHNOLOGY TO REMAIN COMPETITIVE.

The dental device and supply industry is subject to technological change. As technological changes occur in the marketplace, we may have to modify our products in order to become or remain competitive or to ensure that our products do not become obsolete. We sold virtually our entire technology portfolio to Discus and although we have a license to use the existing technology in the Centers, we cannot give assurances that we will be able to either acquire or develop newer technology in the future. If we fail to anticipate or respond in a cost-effective and timely manner to government requirements, market trends or customer demands, or if there are any significant delays in product development or introduction, our revenues and profit margins may decline, which could adversely affect our cash flows, liquidity and operating results.

WE MAY HAVE PROBLEMS FINANCING OUR FUTURE GROWTH.

Our growth strategy includes investment in and expansion of Centers throughout the United States and internationally, increasing awareness of the BriteSmile brand, and developing and marketing our brand name and retail products. To finance our prior growth we have sold debt and equity securities; however, additional funds may be needed in the future for continued expansion. We cannot give assurance that additional financing will be available or that, if available, it will be on terms favorable to our stockholders or us. If needed funds are not available, we may be required to close existing Centers, and/or limit or forego the establishment of new Centers and the development of new products, or limit the scope of our current operations, which could have a material adverse effect on our business, operating results and financial condition. We may be required to take other actions that may lessen the value of our common stock, including borrowing money on terms that are not favorable to us. Raising the needed funds through the sale of additional shares of our common stock or securities convertible into shares of common stock may result in dilution to current stockholders.

WE ARE SUBJECT TO COMPETITION.

The market for teeth whitening products and services is highly competitive. Competition in the market for teeth whitening products and services may intensify in the future. Numerous well-established companies and smaller entrepreneurial companies are focusing significant resources on developing and marketing products and services that will compete with our products and services. In addition, many of our current and potential competitors have greater financial, technical, operational and marketing resources. Teeth whitening products and services offered by our competitors include traditional and often less expensive bleaching tray methods and other forms of heat or light activated curing methods. We may not be able to compete successfully against these competitors in developing, marketing and distributing our services and products, which could result in the loss of customers and could have a material adverse effect on our business. Competitive pressures may also force prices for teeth whitening services down and such price reductions may adversely affect our

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potential future revenue and profitability.

In addition, we recently sold our Associated business to Discus. BriteSmile products and services offered through our Centers will compete directly with BriteSmile products and systems offered through existing independent dental offices.

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WE MAY EXPERIENCE SHORTAGES OF THE SUPPLIES WE NEED BECAUSE WE DO NOT HAVE LONG-TERM AGREEMENTS WITH CERTAIN SUPPLIERS AND RELY ON SOLE SOURCES FOR KEY EQUIPMENT.

Successful operation of our Centers business depends to a degree on our ability to provide our Centers a sufficient supply of teeth whitening gels and maintenance products. Since our BS2000 was first used commercially, we have relied upon manufacturing and supply agreements with multiple suppliers and a single manufacturer of our LATW systems. Effective April 2001, the Company's LATW systems are manufactured by Delphi Medical Systems Corporation, Longmont, Colorado, pursuant to an agreement between the Company and Delphi.

We have no long-term purchase contracts or other contractual assurance of continued supply, pricing or access to new products. While we believe that we have good relationships with our suppliers and our manufacturer, if we are unable to extend or secure manufacturing services or to obtain component parts or finished products from one or more key vendors on a timely basis and on acceptable commercial terms, our results of operations could be seriously harmed.

OUR FUTURE GROWTH WILL DEPEND IN PART ON ADDING NEW CENTERS.

One driver of future growth will be expansion of the number of our Centers. We cannot give assurance that we will be successful in expanding the number of Centers or that such additions will achieve sales levels satisfactory to us. Demand for the Company's services and products is driven by consumers whose broad spending patterns are affected by general economic conditions. Over recent years, we have observed some variability in demand as a result of changing economic conditions, which we believe may relate to fluctuations in the level of consumer discretionary spending. We believe that our performance will continue to be affected by such economic parameters.

WE OPERATE OUR CENTERS USING INTELLECTUAL PROPERTY UNDER A LICENSE GRANTED TO US BY DISCUS DENTAL, AND WE CANNOT GUARANTEE THAT THE UNDERLYING PATENTS WILL NOT BE INFRINGED BY COMPETITORS, OR THAT CERTAIN PATENTS THAT HAVE BEEN APPLIED FOR WILL BE GRANTED.

In connection with the sale of our Associated business to Discus, we sold all of our intellectual property relating to our business to Discus, but we retained a license from Discus permitting us to utilize the intellectual property to operate our Centers business.

There is an expansive and growing portfolio of patents to protect the intellectual property rights licensed to us. In 2002, two patents relating to the LATW systems were granted, including a patent covering a method of whitening teeth by exposing teeth treated with transparent composition including a peroxide and photosensitizing compound to light, and a patent covering the light source. There are also a number of patent applications related to the composition of our whitening gel, tissue isolation useful in light-activated teeth whitening, our business method and our unique system of delivery of light to all teeth simultaneously. We also filed patent applications related to the BriteSmile-to-Go pen.

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THE RIGHTS RELIED UPON TO PROTECT THE INTELLECTUAL PROPERTY LICENSED TO US BY DISCUS UNDERLYING OUR PRODUCTS AND SERVICES MAY NOT BE ADEQUATE, WHICH COULD ENABLE THIRD PARTIES TO USE THE TECHNOLOGY USED BY US AND WOULD REDUCE OUR ABILITY TO COMPETE IN THE MARKET.

The rights licensed to us by Discus rely on a combination of trade secrets, copyright and trademark laws, non-disclosure agreements and other contractual provisions and technical measures to protect our intellectual property rights. Nevertheless, these measures may not be adequate to safeguard the technology underlying our products and services. If these measures do not protect these rights, third parties could use the same technology we use, and our ability to compete in the market would be reduced. In addition, employees, consultants and others who participate in the development of our products and services may breach their agreements with us or Discus regarding intellectual property, and we may not have adequate remedies for the breach. We or Discus also may not be able to effectively protect these intellectual property rights in some foreign countries. We also realize that our and Discus' trade secrets may become known through other means not currently foreseen by us. Notwithstanding our and Discus' efforts to protect this intellectual property, our competitors may independently develop similar or alternative technologies or products that are equal or superior to the technology and products used by us without infringing on any of the intellectual property rights or designs we use.

OUR PRODUCTS OR SERVICES COULD INFRINGE ON THE INTELLECTUAL PROPERTY RIGHTS OF OTHERS, WHICH MAY CAUSE US TO ENGAGE IN COSTLY LITIGATION AND, IF WE ARE NOT SUCCESSFUL, COULD ALSO CAUSE US TO PAY SUBSTANTIAL DAMAGES AND PROHIBIT US FROM SELLING OUR PRODUCTS OR SERVICES.

Third parties may assert infringement or other intellectual property claims against us. We may have to pay substantial damages, including treble damages, for past infringement if it is ultimately determined that our products or services infringe a third party's proprietary rights.

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Further, we may be prohibited from selling our products before we obtain a license, which, if available at all, may require us to pay substantial royalties. Even if these claims are without merit, defending a lawsuit takes significant time, may be expensive and may divert management's attention from other business concerns. Notwithstanding the foregoing, we are not aware of any infringement claims asserted against us by others.

WE ARE SUBJECT TO GOVERNMENT REGULATION REGARDING THE CORPORATE PRACTICE OF DENTISTRY.

Our corporate structure, the operation of Centers and contractual relationships with the licensed dentists at our Centers are subject to government regulation and may be reviewed by applicable state agencies governing the practice of dentistry (such as a Board of Dental Examiners). We believe that our present and contemplated operation of Centers is and will be in compliance in all material respects with applicable federal, state and local laws and regulations, and that favorable review of our corporate structure would be obtained from any state agency which chooses to review our operational structure. However, we cannot give assurance that such favorable review would be obtained in all instances. If we are unable to obtain favorable review, we may be subject to penalties. We continue to cooperate with state regulatory agencies to respond to any requests for information about our business structure and to obtain any necessary governmental approvals. We cannot give assurance that future enactments, amendments or interpretations of government regulations will not be more stringent, and will not require structural, organizational or

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operational modifications to our existing or future contractual relationships with the licensed dentists at our Centers who provide our services.

WE MAY BECOME SUBJECT TO GOVERNMENT REGULATION REGARDING OUR TEETH WHITENING SERVICES AND PRODUCTS.

The light used in the LATW systems is categorized as a Class I Medical Device as defined by the Food and Drug Administration ("FDA"). As long as the light is used specifically to perform cosmetic dental procedures (teeth whitening), it is not subject to pre-market notification requirements, although we are subject to FDA requirements regarding handling of complaints and other general FDA record keeping standards. There can be no assurance that some or all of the existing government regulations will not change significantly or adversely in the future, or that we will not become subject to compliance with additional and stricter government regulations which could, in the future, affect our revenue.

OWNERSHIP OF OUR COMMON STOCK IS CONCENTRATED IN A LIMITED NUMBER OF SHAREHOLDERS.

Current directors and executive officers of the Company, or their affiliates, own and control more than a majority of the outstanding common stock of the Company and, therefore, have ultimate authority to make all major decisions affecting our business, including the identity and make-up of the Company's board of directors and any other matters requiring approval of the shareholders of the Company.

OUR EFFORTS TO BUILD STRONG BRAND IDENTITY AND CUSTOMER LOYALTY MAY NOT BE SUCCESSFUL.

We believe that establishing and maintaining brand identity and brand loyalty is critical to attracting customers and strategic partners. In order to attract and retain these groups and respond to competitive pressures, we intend to continue advertising spending to create and maintain brand loyalty. However, as a result of the sale of our Associated Centers business, we intend to reduce spending on advertising. We do not yet know if the reduced advertising will result in a material reduction in revenues. We believe that advertising rates, and the cost of advertising campaigns in particular, could increase in the future. If our branding efforts are not successful, our results of operations could be adversely affected.

Promotion and enhancement of the Company's brand will also depend on our success in consistently providing a high-quality customer experience for our teeth whitening services and satisfaction with our products. If customers do not perceive our service and product offerings to be of high quality, or if we introduce new services and products that are not favorably received, the value of the Company's brand could be harmed. Any brand impairment or dilution could decrease the attractiveness of the Company, which could harm our reputation, reduce our net revenue and cause us to lose customers.

CHANGES IN REQUIRED ACCOUNTING PRACTICES MAY AFFECT OUR REPORTED OPERATING RESULTS AND STOCK PRICE.

Any future changes to applicable Generally Accepted Accounting Procedures or additional SEC statements on relevant accounting policies may require us to further change our practices. These uncertainties may cause our reported operating results and stock price to decline.

FAILURES IN OUR INFORMATION TECHNOLOGY SYSTEMS OR THE SYSTEMS OF THIRD PARTIES

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COULD ADVERSELY AFFECT OUR BUSINESS AND RESULT IN A LOSS OF CUSTOMERS.

Our web site and our Internet-based Scheduler system may experience slow response times, decreased capacity to accommodate a large number of customers or a temporary disruption in service for a variety of reasons. Additionally, power outages and delays in such service may interrupt or prevent us from immediately coordinating with the schedules of Centers, and may interrupt or prevent customers from arranging for our services or from ordering our products through our e-Commerce Internet site. Any of these potential problems could have an adverse effect on business.

Computer hardware and software components to our Scheduler system are located at a third party co-location. In addition, a back-up file server and tape back-ups of the Scheduler database reside both at our headquarters and off-site. Delays in scheduling teeth whitening procedures would result if we were required to use our backup computer hardware and software systems. Nevertheless, natural disasters such as floods, fires, power outages, telecommunications failures, physical or electronic break-ins or vandalism, viruses and other similar events could damage our hardware and software systems, lead to a loss of data, cause substantial disruption in our business operations and have a material adverse effect on our business.

WE ARE SUSCEPTIBLE TO PRODUCT LIABILITY SUITS AND IF A LAWSUIT IS BROUGHT AGAINST US IT COULD RESULT IN US HAVING TO PAY LARGE LEGAL EXPENSES AND JUDGMENTS.

Because of the nature of the dental device industry, there can be no assurance that we will not be subject to claims against us related to our products or services. Our products come into contact with vulnerable areas of the human body, such as the mouth, tongue, teeth and gums, and, therefore, the sale and support of dental products makes us susceptible to the risk of such claims. A successful product liability claim or claim arising as a result of use of our products or services brought against us, or the negative publicity brought up by such claim, could have a material adverse effect on our business. We maintain product liability insurance with coverage limits of at least \$5 million per occurrence and \$5 million per year. While we believe that we maintain adequate insurance coverage that is reasonable and customary for our business, we cannot give assurance that the amount of insurance will be adequate to satisfy claims made against us in the future, or that we will be able to obtain insurance in the future at satisfactory rates or in adequate amounts.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

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

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

3.01 Articles of Restatement of the Articles of Incorporation of the Company as filed with the Utah Division of Corporations and Commercial Code on January 17, 2003 (incorporated by reference to the Company's Annual

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Report on Form 10-K for the fiscal year ended December 28, 2002).

- 3.02 Articles of Amendment to the Articles of Incorporation of the Company as filed with the Utah Division of Corporations and Commercial Code effective January 30, 2004 (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 27, 2003).
- 3.03 Bylaws adopted May 2, 1996, (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 1996).
- 3.04 Amendment to Bylaws adopted July 23, 1999 (incorporated by reference to the Company's Quarterly Report on Form 10-QSB for the quarter ended June 30, 1999).

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- 10.01 Registration Rights Agreement dated April 1, 1996 between the Company, LCO Investments Limited, Richard S. Braddock, and Pinnacle Fund, L.P. (incorporated by reference to the Current Report on Form 8-K of the Company dated April 1, 1996).
- 10.02 Registration Rights Agreement dated May 8, 1997 among the Company, LCO Investments Limited, and Richard S. Braddock (incorporated by reference to the Company's Annual Report on Form 10-KSB for the fiscal year ended March 31, 1997).
- 10.03 Registration Rights Agreement dated as of May 4, 1998 between the Company and LCO Investments Limited (incorporated by reference to the Company's Annual Report on Form 10-KSB for the fiscal year ended March 31, 1998).
- 10.04\* Revised 1997 Stock Option and Incentive Plan of the Company, as amended through June 20, 2001 (incorporated by reference to the Company's Annual Report on Form 10-K for the 52 weeks ended December 29, 2001).
- 10.05\* Form of Option Agreement between the Company and certain directors of the Company (incorporated by reference to the Company's Annual Report on Form 10-K for the 52 weeks ended December 29, 2001).
- 10.06\* Form of Option Agreement between the Company and certain employees of the Company (incorporated by reference to the Company's Annual Report on Form 10-K for the 52 weeks ended December 29, 2001).
- 10.07 Registration Rights Agreement dated as of June 3, 1999 between the Company and the non-management purchasers (incorporated by reference to the Company's Current Report on Form 8-K as filed June 21, 1999).
- 10.08 Amended and Restated Registration Rights Agreement dated as of June 3, 1999 between the Company and the management purchasers (incorporated by reference to the Company's Current Report on Form 8-K as filed June 21, 1999).
- 10.09 Registration Rights Agreement dated as of June 3, 1999 between the Company and certain non-management purchasers in the June 1999 Private Placement (incorporated by reference to the Company's Current Report on Form 8-K dated June 4, 1999).
- 10.10 Amended and Restated Registration Rights Agreement dated as of June 3, 1999 between the Company and certain management purchasers (incorporated by reference to the Company's Current Report on Form 8-K

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as filed June 4, 1999).

- 10.11 Registration Rights Agreement dated as of January 18, 2000 between the Company and the Pequot Funds (incorporated by reference to the Company's Current Report on Form 8-K dated January 18, 2000).
  - 10.12 Agreement of Sublease dated December 1999 between the Company and LCO Properties, Inc. (incorporated by reference to the Company's Annual Report on Form 10-KSB for the fiscal year ended April 1, 2000).
  - 10.13 Form of Warrants granted to note purchasers pursuant to the Securities Purchase Agreement dated as of June 27, 2000 (incorporated by reference to the Company's Transition Report on Form 10-K for the Nine-month Transition Period ended December 30, 2000).
  - 10.14 Form of Registration Rights Agreement between the Company of the purchasers of Notes pursuant to the Securities Purchase Agreement dated as of June 27, 2000 (incorporated by reference to the Company's Transition Report on Form 10-K for the Nine-month Transition Period ended December 30, 2000).
  - 10.15 Convertible Promissory Note dated December 5, 2000 in the principal amount of \$5,000,000 (incorporated by reference to the Company's Current Report on Form 8-K dated December 5, 2000).
  - 10.16 Warrant to Purchase 250,000 Shares of common stock of the Company dated December 5, 2000 (incorporated by reference to the Company's Current Report on Form 8-K dated December 5, 2000).
  - 10.17 Amended and Restated Agreement between Excimer Vision Leasing L.P. and the Company dated February 2001 (incorporated by reference to the Company's Transition Report on Form 10-K for the Nine-month Transition Period ended December 30, 2000).
  - 10.18 Amendment dated September 18, 2002 to Amended and Restated Agreement between Excimer Vision Leasing L.P. and the Company dated February 2001 (incorporated by reference to the Company's Annual Report on Form 10-K for the 52 weeks ended December 28, 2002).
  - 10.19 Amendment dated January 1, 2003 to Amended and Restated Agreement between Excimer Vision Leasing L.P. and the Company dated February 2001 (incorporated by reference to the Company's Annual Report on Form 10-K for the 52 weeks ended December 28, 2002).
  - 10.20 Loan Agreement between Excimer Vision Leasing L.P. and the Company dated as of March 1, 2001 (incorporated by reference to the Company's Transition Report on Form 10-K for the Nine-month Transition Period ended December 30, 2000).
  - 10.21 Unsecured Credit Agreement between BriteSmile International and CAP Advisers Limited dated March 2002 (incorporated by reference to the Company's Annual Report on Form 10-K for the 52 weeks ended December 29, 2001).
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- 10.22 Credit and Security Agreement dated December 13, 2001 between BriteSmile International and CAP Advisers Limited (incorporated by reference to the Company's Annual Report on Form 10-K for the 52 weeks ended December 29, 2001).

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- 10.23 Supplemental Agreement dated March 2002 to Credit and Security Agreement dated December 13, 2001 between BriteSmile International and CAP Advisers Limited (incorporated by reference to the Company's Annual Report on Form 10-K for the 52 weeks ended December 29, 2001).
- 10.24 Supplemental Agreement dated July 19, 2002 to Credit and Security Agreement dated December 13, 2001, as amended, and to Unsecured Credit Agreement dated March 8, 2002 (incorporated by reference to the Quarterly Report on Form 10-Q of the Company for the 13 weeks ended June 29, 2002).
- 10.25 Supplemental Agreement dated January 9, 2003 to Credit and Security Agreement dated March 2002 (incorporated by reference to the Company's Annual Report on Form 10-K for the 52 weeks ended December 28, 2002).
- 10.26 Amendment to Lease Agreement between Excimer Vision Leasing L.P. and the Company dated March 8, 2002 (incorporated by reference to the Company's Annual Report on Form 10-K for the 52 weeks ended December 29, 2001).
- 10.27 Form of Guaranty of Fiscal 2002 Shortfall Summary of Terms dated March 2002 in connection with commitments from certain shareholders and/or directors of the Company to secure up to \$4 million of additional working capital (incorporated by reference to the Company's Annual Report on Form 10-K for the 52 weeks ended December 29, 2001).
- 10.28 Form of Convertible Promissory Note issued in connection with November 20, 2002 convertible note offering (incorporated by reference to the Current Report on Form 8-K of the Company filed on November 25, 2002).
- 10.29 CAP Line Conversion Agreement dated as of November 20, 2003 between the Company and LCO Investments Limited (incorporated by reference to the Current Report on Form 8-K of the Company filed on November 28, 2003).
- 10.30 Demand Promissory Note dated November 20, 2003 payable by the Company to LCO Investments Limited in the principal amount of \$2,000,000 (incorporated by reference to the Current Report on Form 8-K of the Company filed on November 28, 2003).
- 10.31 Amendment to Lease Agreement between Excimer Vision Leasing L.P. and the Company dated December 12, 2003 (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 27, 2003).
- 10.32 Receivable Conversion Agreement dated November 20, 2003 between the Company and Excimer Vision Leasing L.P. (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 27, 2003).
- 10.33 Amended and Restated Consulting Agreement dated December 27, 2003 between the company and John Warner (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 27, 2003).
- 10.34\* Employment Agreement, Confidentiality and Rights Ownership Agreement, Common Stock Purchase Option and Restricted Stock Grant Agreement each dated January 9, 2005 between the Company and Gregg A. Coccari (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 25, 2004).
- 10.35 Form of Securities Purchase Agreement dated as of December 16, 2004, between the Company and the Investors, together with exhibits including



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form of Senior Convertible Note dated December 16, 2004, due December 16, 2009; form of Warrant to Purchase Common Stock of the Company dated December 16, 2004; and form of Additional Investment Right between the Company and the Investors (incorporated by reference to the Current Report on Form 8-K of the Company filed on December 21, 2004).

- 10.36 July 2003 Asset Purchase Agreement between BDI and R. Eric Montgomery (incorporated by reference to the Quarterly Report on Form 10-Q of the Company filed on August 12, 2003).
- 10.37 Consulting Agreement between BDI and Oraceutical Innovative Properties (incorporated by reference to the Quarterly Report on Form 10-Q of the Company filed on August 12, 2003).
- 10.38 \$2 million promissory note issued by BDI to LCO Investments Limited (incorporated by reference to the Quarterly Report on Form 10-Q of the Company filed on August 12, 2003).
- 10.39 Supply Agreement dated December 21, 2004 between the Company and Oraceutical, LLC (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 25, 2004).

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- 10.40 \$2.5 million loan agreement between BSML and CAP America Trust: See Agreement dated May 7, 2003 between the Company and CAP America Trust (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 25, 2004).
- 10.41 Amendment to Lease Agreement between Excimer Vision Leasing L.P. and the Company dated July 12, 2005 (incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on November 8, 2005).
- 10.42 Asset Purchase Agreement among BSML, BriteSmile International Limited, BriteSmile Development, Inc. and Discus Dental, Inc. dated December 30, 2005 (incorporated by reference to the Current Report on Form 8-K of the Company filed on January 4, 2006).
- 10.43 Limited Liability Company Membership Interest Purchase Agreement between BSML and Dental Spas, LLC dated January 13, 2006 (incorporated by reference to the Current Report on Form 8-K of the Company filed on January 19, 2006).
- 10.44 Contribution Agreement between BSML and BriteSmile Spas, LLC dated January 13, 2006. (incorporated by reference to the Current Report on Form 8-K of the Company filed on January 19, 2006).
- 10.45\* Letter Agreement between BSML and Ken Czaja dated May 4, 2006 (Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on August 21, 2006).
- 31.1 Certification of Principal 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 Principal 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

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Sarbanes-Oxley Act of 2002 (Filed Herewith).

\* Denotes management contract or compensatory plan or arrangement.

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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.

BSML, INC.

NOVEMBER 14, 2006

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DATE

/S/ JOHN REED

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JOHN REED  
CHIEF EXECUTIVE OFFICER  
(PRINCIPAL EXECUTIVE OFFICER)

NOVEMBER 14, 2006

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DATE

/S/ KEN CZAJA

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KEN CZAJA  
EVP, CHIEF FINANCIAL OFFICER  
(PRINCIPAL FINANCIAL AND  
ACCOUNTING OFFICER)

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