CUTERA INC
Form 10-Q
May 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2018

OR

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

For the transition period _____ to_____.

Commission file number: 000-50644

Cutera, Inc.

(Exact name of registrant as specified in its charter)

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

3240 Bayshore Blvd., Brisbane, California 94005

(Address of principal executive offices)

(415) 657-5500

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares of Registrant’s common stock issued and outstanding as of April 30, 2018, was 13,634,482

Table of Contents

CUTERA, INC.

FORM 10-Q

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CUTERA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(unaudited)

	March 31, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 10,910	$ 14,184
Marketable investments	13,062	21,728
Accounts receivable, net	19,862	20,777
Inventories	30,979	28,782
Other current assets and prepaid expenses	2,601	2,903
Total current assets	77,414	88,374
Property and equipment, net	2,214	2,096
Deferred tax asset	21,792	19,055
Goodwill	1,339	1,339
Other long-term assets	5,367	374
Total assets	$ 108,126	$ 111,238
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 8,206	$ 7,002
Accrued liabilities	20,083	26,848
Deferred revenue	8,847	9,461
Total current liabilities	37,136	43,311
Deferred revenue, net of current portion	2,168	2,195
Income tax liability	384	379

Other long-term liabilities	*583*	*460*
Total liabilities	40,271	*46,345*
Commitments and Contingencies (Note 12)		
Stockholders’ equity:		
Convertible preferred stock, $0.001 par value; authorized: 5,000,000 shares; none issued and outstanding	—	—
Common stock, $0.001 par value; authorized: 50,000,000 shares; issued and outstanding: 13,634,154 and 13,477,973 shares at March 31, 2018 and December 31, 2017, respectively	*14*	*13*
Additional paid-in capital	*62,057*	*62,025*
Retained earnings	5,888	*2,947*
Accumulated other comprehensive loss	*(104*)	*(92*)
Total stockholders’ equity	67,855	*64,893*
Total liabilities and stockholders’ equity	$ 108,126	$ *111,238*

The accompanying notes are an integral part of these unaudited Condensed Consolidated Financial Statements.

Table of Contents

CUTERA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended March 31, 2018	2017
Net revenue:		
Products	$29,264	$24,475
Service	4,861	4,824
Total net revenue	34,125	29,299
Cost of revenue:		
Products	13,922	11,144
Service	2,869	2,634
Total cost of revenue	16,791	13,778
Gross profit	17,334	15,521
Operating expenses:		
Sales and marketing	13,088	10,773
Research and development	3,556	2,945
General and administrative	5,439	3,216
Total operating expenses	22,083	16,934
Loss from operations	(4,749)	(1,413)
Interest and other income, net	98	273
Loss before income taxes	(4,651)	(1,140)
Benefit for income taxes	(2,619)	(118)
Net loss	$(2,032)	$(1,022)
Net loss per share:		
Basic and Diluted	$(0.15)	$(0.07)
Weighted-average number of shares used in per share calculations:		
Basic and Diluted	13,587	13,840

The accompanying notes are an integral part of these unaudited Condensed Consolidated Financial Statements.

4

Table of Contents

CUTERA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)

(unaudited)

	Three Months Ended March 31,	
	2018	**2017**
Net loss	$(2,032)	$(1,022)
Other comprehensive loss:		
Available-for-sale investments		
Net change in unrealized gain (loss) on available-for-sale investments	(21)	3
Less: Reclassification adjustment for (gains) losses on investments recognized during the period	9	(4)
Net change in unrealized loss on available-for-sale investments	(12)	(1)
Tax loss (benefit)	—	—
Other comprehensive loss, net of tax	(12)	(1)
Comprehensive loss	$(2,044)	$(1,023)

The accompanying notes are an integral part of these unaudited Condensed Consolidated Financial Statements.

Table of Contents

CUTERA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended March 31, 2018	2017
Cash flows from operating activities:		
Net loss	$(2,032)	$(1,022)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation	1,688	1,395
Depreciation of tangible assets	254	248
Amortization of contract acquisition costs	373	—
Change in deferred tax asset	(2,737)	(17)
Other	25	(34)
Changes in assets and liabilities:		
Accounts receivable	915	(1,305)
Inventories	(2,197)	(695)
Other current assets and prepaid expenses	1,753	(158)
Other long-term assets	(2,150)	(9)
Accounts payable	1,204	491
Accrued liabilities	(6,727)	(2,657)
Deferred revenue	(456)	(23)
Other long-term liabilities	40	1
Net cash used in operating activities	(10,047)	(3,785)
Cash flows from investing activities:		
Acquisition of property, equipment and software	(104)	(69)
Disposal of property and equipment	—	25
Proceeds from sales of marketable investments	13,044	5,255
Proceeds from maturities of marketable investments	—	14,035
Purchase of marketable investments	(4,390)	(15,972)
Net cash provided by investing activities	8,550	3,274
Cash flows from financing activities:		
Repurchase of common stock	—	(2,700)
Proceeds from exercise of stock options and employee stock purchase plan	633	1,751
Taxes paid related to net share settlement of equity awards	(2,288)	(784)
Payments on capital lease obligations	(122)	(88)

Net cash used in financing activities	(1,777)	(1,821)
Net decrease in cash and cash equivalents	(3,274)	(2,332)
Cash and cash equivalents at beginning of period	14,184	13,775
Cash and cash equivalents at end of period	$10,910	$11,443
Supplemental disclosure of non-cash items:		
Repurchase of common stock acquired but not settled	—	$207
Assets acquired under capital lease	$284	$80

The accompanying notes are an integral part of these unaudited Condensed Consolidated Financial Statements.

Table of Contents

CUTERA, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note *1.* Summary of Significant Accounting Policies

Description of Operations and Principles of Consolidation

Cutera, Inc. ("Cutera" or the "Company") is a global provider of laser and other energy-based aesthetic systems for practitioners worldwide. The Company designs, develops, manufactures, and markets laser and other energy-based product platforms for use by physicians and other qualified practitioners which enable them to offer safe and effective aesthetic treatments to their customers. The Company currently markets the following key system platforms: *excel V, excel HR, enlighten, Juliet, Secret RF, truSculpt* and *xeo*. The Company's systems offer multiple hand pieces and applications, which allow customers to upgrade their systems. The sales of (i) systems, system upgrades and hand pieces (classified as "Systems" revenue); (ii) hand piece refills applicable to *Titan and truSculpt 3D*, as well as single use disposable tips applicable to *Juliet, Secret RF* (classified as "Consumables"); and (iii) the distribution of *third* party manufactured skincare products (classified as "Skincare" revenue); and collectively classified as "Products" revenue. In addition to Products revenue, the Company generates revenue from the sale of post-warranty service contracts, parts, detachable hand piece replacements (except for *Titan* and *truSculpt 3D*) and service labor for the repair and maintenance of products that are out of warranty, all of which is classified as "Service" revenue.

Headquartered in Brisbane, California, the Company has wholly-owned subsidiaries that are currently operational in Australia, Belgium, Canada, France, Germany, Hong Kong, Japan, Spain, Switzerland and the United Kingdom. These subsidiaries market, sell and service the Company's products outside of the United States.

Unaudited Interim Financial Information

In the opinion of the Company, the accompanying unaudited Condensed Consolidated Financial Statements included in this report reflect all adjustments (consisting of only normal recurring adjustments) necessary for a fair statement of its financial position as of *March 31, 2018,* its results of operations for the *three* months period ended *March 31, 2018,* and *2017,* comprehensive loss for the *three* months period ended *March 31, 2018* and *2017,* and cash flows for the *three* months ended *March 31, 2018,* and *2017.* The *December 31, 2017* Condensed Consolidated Balance Sheet was derived from audited financial statements, but does *not* include all disclosures required by generally accepted accounting principles in the United States of America ("GAAP"). The results for interim periods are *not* necessarily indicative of the results for the entire year or any other interim period. The accompanying condensed consolidated financial statements should be read in conjunction with the Company's previously filed audited financial statements and the related notes thereto included in the Company's annual report on Form *10*-K for the year ended *December 31, 2017* filed with the Securities and Exchange Commission (the "SEC") on *March 26, 2018.*

Use of Estimates

The preparation of interim Condensed Consolidated Financial Statements in conformity with GAAP requires the Company's management to make estimates and assumptions that affect the amounts reported of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Condensed Consolidated Financial Statements and the accompanying notes, and the reported amounts of revenue and expenses during the reported periods. Actual results could differ materially from those estimates.

On an ongoing basis, the Company evaluates their estimates, including those related to warranty obligation, sales commission, accounts receivable and sales allowances, valuation of inventories, fair values of goodwill, useful lives of property and equipment, assumptions regarding variables used in calculating the fair value of the Company's equity awards, expected achievement of performance based vesting criteria, fair value of investments, the standalone selling price of the Company's products and services, the customer life and period of benefit used to capitalize and amortize contracts acquisition costs, variable consideration, contingent liabilities, recoverability of deferred tax assets, and effective income tax rates, among others. Management bases their estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Risks and Uncertainties

The Company's future results of operations involve a number of risks and uncertainties. Factors that could affect the Company's future operating results and cause actual results to vary materially from expectations include, but are *not* limited to, rapid technological change, continued acceptance of the Company's products, stability of world financial markets, management of international activities, competition from substitute products and larger companies, ability to obtain regulatory approval, government regulations, patent and other litigations, ability to protect proprietary technology from counterfeit versions of the Company's products, strategic relationships and dependence on key individuals. If the Company fails to adhere to ongoing Food and Drug Administration (the "FDA") Quality System Regulation, the FDA *may* withdraw its market clearance or take other action. The Company's manufacturers and suppliers *may* encounter supply interruptions or problems during manufacturing due to a variety of reasons, including failure to comply with applicable regulations, including the FDA's Quality System Regulation, equipment malfunction and environmental factors, any of which could delay or impede the Company's ability to meet demand.

Table of Contents

Comparability

The Company adopted the new revenue standard effective *January 1, 2018,* using the modified retrospective method. Prior period financial statements were *not* retrospectively restated. The consolidated balance sheet as of *December 31, 2017* and results of operations for the *three* months ended *March 31, 2017* were prepared using accounting standards that were different than those in effect for the *three* months ended *March 31, 2018.* As a result the consolidated balance sheets as of *March 31, 2018* and *December 31, 2017* are *not* directly comparable, nor are the results of operations for the *three* months ended *March 31, 2018* and *March 31, 2017.*

Adopted Accounting Pronouncements

In *May 2014,* the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") *2014-09,* "Revenue from Contracts with Customers," amending revenue recognition guidance and requiring more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The amended guidance, herein referred to as Topic *606,* is effective for annual and interim reporting periods beginning after *December 15, 2017,* with early adoption permitted for public companies effective for annual and interim reporting periods beginning after *December 15, 2016.* The Company adopted the new revenue standard in the *first* quarter of fiscal year *2018* using the modified retrospective method. The Company recognized the cumulative effect of applying the new revenue standard as an adjustment to retained earnings. The comparative information has *not* been restated and continues to be reported under the accounting standards in effect for the period presented.

See Note *2* – Revenue Recognition, for additional accounting policy and transition disclosures.

In *August 2016,* the FASB issued ASU *2016-15,* Statement of Cash Flows (Topic *230*), which intends to reduce diversity in practice in how certain cash receipts and cash payments are classified in the statement of cash flows. This guidance is effective for the Company in the *first* quarter of *2018.* The Company adopted the standard in the *first* quarter of fiscal year *2018.* The adoption did *not* have any material impact on the Company's consolidated financial statements.

In *November 2016,* the FASB issued ASU *2016-18,* Statement of Cash Flows (Topic *320*), which amended the guidance on the classification and presentation of restricted cash in the statement of cash flow. The amendment requires entities to include restricted cash and restricted cash equivalents in its cash and cash equivalents in the statement of cash flow. The amendment is effective for the Company in the *first* quarter of *2018* and is required to be adopted retrospectively. The Company adopted the standard in the *first* quarter of fiscal year *2018.* The adoption did *not* have any material impact on the Company's consolidated financial statements.

Other Accounting Pronouncements

In *February 2016,* the FASB issued ASU *No. 2016-02,* Leases (Topic *842*), which amends the existing accounting standards for leases. The new standard requires lessees to record a right-of-use asset and a corresponding lease liability on the balance sheet (with the exception of short-term leases). The new standard also requires expanded disclosures regarding leasing arrangements. The new standard becomes effective for the Company in the *first* quarter of fiscal year *2019* and early adoption is permitted. The new standard is required to be adopted using the modified retrospective approach and requires application of the new standard at the beginning of the earliest comparative period presented. The Company finances its fleet of vehicles used by its field sales and service employees and has facility leases. Several of the Company's customers finance purchases of its system products through *third* party lease companies and *not* directly with the Company. The Company does *not* believe that the new standard will change customer buying patterns or behaviors for its products. The Company will adopt the new standard effective *January 1, 2019.* The Company expects that upon adoption, right-of-use assets and lease liabilities will be recognized in the balance sheet in amounts that will be material.

Note *2.* Revenue recognition

The Company adopted ASC Topic *606,* Revenue from Contracts with Customers, on *January 1, 2018,* applying the modified retrospective method to all contract agreements that were *not* completed as of *January 1, 2018.* Results for reporting periods beginning after *January 1, 2018* are presented under Topic *606,* while prior period amounts are *not* adjusted and continue to be reported under the accounting standards in effect for the prior period. A cumulative catch up adjustment was recorded to beginning retained earnings to reflect the impact of all existing arrangements under Topic *606.*

Upon adoption of the Topic *606,* the Company recorded an increase to retained earnings of $5.*0* million for contracts still in force as of *January 1, 2018* for the following items in the *first* quarter of *2018*:

$237,000 reduction in deferred revenue balances for the differences in the amount of revenue recognition for the Company's revenue streams as a result of allocation of revenue based on standalone selling prices to the Company's various performance obligations.

*$*151,000 increase in deferred revenue balances, related to the accretion of financing costs for multi-year post-warranty service contracts for customers who pay more than one year in advance of receiving the service. The Company estimated interest expense for such advance payments under the new revenue standard.

$210,000 for variable consideration on sale transactions.

*$*4.7 million for the capitalization of the incremental contract acquisition costs, such as sales commissions paid in connection with system sales. These contract acquisition costs were capitalized and amortized over the period of anticipated support renewals. Under the prior guidance, the Company expensed such costs when incurred.

The Company's revenue consists of product and service revenue resulting from the sale of systems, training on the systems, extended service contracts, consumables and other accessories. The Company accounts for a contract with a customer when there is a legally enforceable contract between the Company and the customer, the rights of the parties are identified, the contract has commercial substance, and collectability of the contract consideration is probable. Revenues are recognized when control of the promised goods or services are transferred to our customers, in an amount that reflects the consideration that we expect to receive in exchange for those goods or services.

The Company's system sale arrangements generally contain multiple products and services. For these bundled sale arrangements, the Company accounts for individual products and services as separate performance obligations if they are distinct, which is if a product or service is separately identifiable from other items in the bundled package, and if a customer can benefit from it on its own or with other resources that are readily available to the customer. The Company's system sale arrangements include a combination of the following performance obligations: The System and software license (considered as *one* performance obligation), system accessories (hand pieces), training, other accessories, extended service contracts and marketing services. For the Company's system sale arrangements that include an extended service contract, the period of service commences at the expiration of the Company's standard warranty offered at the time of the system sale. The Company considers the extended service contracts terms in the arrangements that are legally enforceable to be performance obligations. Other than service and training, the Company generally satisfies all of the performance obligations at a point in time. System, system accessories (hand pieces), training, and service are also sold on a stand-alone basis, and related performance obligations are satisfied over time as the services are performed.

Table of Contents

The following table summarizes the effects of adopting Topic *606* on the Company's condensed consolidated balance sheet as of *March 31, 2018:*

	As reported under Topic 606	Adjustments	Balances under Prior GAAP
	(In thousands)		
Other long-term assets	*5,367*	*4,862*	*505*
Accrued Liabilities	20,083	(111)	20,194
Deferred revenue	*11,015*	*(194)*	10,821
Retained earnings	5,888	5,167	721

The following table summarizes the effects of adopting Topic *606* on Company's condensed consolidated income statement for the *three* months ended *March 31, 2018:*

	As reported under Topic 606	Adjustments	Balances under Prior GAAP
	(In thousands, except per share amounts)		
Products revenue	$29,264	$ *10*	$29,254
Service revenue	*4,861*	64	*4,797*
Sales and marketing	*13,088*	*(185)*	*13,273*
Interest and other income, net*	*98*	*(65)*	*163*

* Included in interest and other income, net is the estimated interest expense for advance payment related to contract services under the new revenue standard going forward. Adoption of the standard had no impact to total net cash from or used in operating, investing, or financing activities within the Condensed Consolidated Statements of Cash Flows.

As part of the Company's adoption of ASC 606, the Company elected to use the following practical expedients (i) not to adjust the promised amount of consideration for the effects of a significant financing component when the Company expects, at contract inception, that the period between the Company's transfer of a promised product or service to a customer and when the customer pays for that product or service will be one year or less; (ii) to expense costs as incurred for costs to obtain a contract when the amortization period would have been one year or less; (iii) not to recast revenue for contracts that begin and end in the same fiscal year; and (iv) not to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract with the customer.

Table of Contents

Note *3.* Cash, Cash Equivalents and Marketable Investments

The Company invests its cash primarily in money market funds and in highly liquid debt instruments of U.S. federal and municipal governments and their agencies, commercial paper and corporate debt securities. All highly liquid investments with stated maturities of *three* months or less from date of purchase are classified as cash equivalents; all highly liquid investments with stated maturities of greater than *three* months are classified as marketable investments. The majority of the Company’s cash and investments are held in U.S. banks and its foreign subsidiaries maintain a limited amount of cash in their local banks to cover their short term operating expenses.

The Company determines the appropriate classification of its investments in marketable securities at the time of purchase and re-evaluates such designation at each balance sheet date. The Company’s marketable securities have been classified and accounted for as available-for-sale. Investments with remaining maturities more than *one* year are viewed by the Company as available to support current operations, and are classified as current assets under the caption marketable investments in the accompanying Consolidated Balance Sheets. Investments in marketable securities are carried at fair value, with the unrealized gains and losses reported as a component of stockholders’ equity. Any realized gains or losses on the sale of marketable securities are determined on a specific identification method, and such gains and losses are reflected as a component of interest and other income, net.

The following tables summarize the components, and the unrealized gains and losses position, related to the Company’s cash, cash equivalents and marketable investments (in thousands):

March 31, 2018	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Market Value**
Cash and cash equivalents:				
Cash	$ *10,579*	$ —	$ —	$ *10,579*
Money market funds	*331*	—	—	*331*
Total cash and cash equivalents	*10,910*	—	—	*10,910*
Marketable investments:				
U.S. government notes	*7,110*	—	*(14*)	*7,096*
Municipal securities	*201*	—	*(1*)	*200*
Corporate debt securities	*5,795*	*1*	*(30*)	*5,766*
Total marketable investments	*13,106*	*1*	*(45*)	*13,062*
Total cash, cash equivalents and marketable investments	$ *24,016*	$ *1*	$ *(45*)	$ *23,972*

December 31, 2017	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Market Value**
Cash and cash equivalents:				
Cash	$ *14,058*	$ —	$ —	$ *14,058*
Money market funds	*126*	—	—	*126*
Total cash and cash equivalents	*14,184*	—	—	*14,184*
Marketable investments:				
U.S. government notes	*11,885*	—	*(15*)	*11,870*
Municipal securities	*201*	—	*(1*)	*200*
Commercial paper	*1,836*	—	*(3*)	*1,833*
Corporate debt securities	*7,838*	*2*	*(15*)	*7,825*
Total marketable investments	*21,760*	*2*	*(34*)	*21,728*
Total cash, cash equivalents and marketable investments	$ *35,944*	$ *2*	$ *(34*)	$ *35,912*

11

Table of Contents

As of *March 31, 2018* and *December 31, 2017,* the net unrealized losses were *$45,000* and *$34,000,* respectively, and were related to interest rate changes on available-for-sale marketable investments. The Company has concluded that it is more-likely-than-*not* that the securities will be held until maturity or the recovery of their cost basis. *No* securities were in an unrealized loss position for more than *12* months.

The following table summarizes the contractual maturities of the Company's available-for-sale securities, classified as marketable investments as of *March 31, 2018 (*in thousands):

	Amount
Due in less than one year	$ *11,867*
Due in 1 to 3 years	*1,195*
Total marketable investments	$ *13,062*

Note *4.* Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as considers counterparty credit risk in its assessment of fair value. Carrying amounts of the Company's financial instruments, including cash equivalents, accounts receivable, accounts payable and accrued liabilities, approximate their fair values as of the balance sheet dates because of their generally short maturities. The fair value hierarchy distinguishes between (*1*) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (*2*) an entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of *three* broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level *1*) and the lowest priority to unobservable inputs (Level *3*). The *three* levels of the fair value hierarchy are described below in accordance to ASC *820:*

Level *1:* Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities.

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

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

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as considers counterparty credit risk in its assessment of fair value.

As of *March 31, 2018,* financial assets measured and recognized at fair value on a recurring basis and classified under the appropriate level of the fair value hierarchy as described above were as follows (in thousands):

March 31, 2018	**Level 1**	**Level 2**	**Level 3**	**Total**
Cash equivalents:				
Money market funds	$ *331*	$—	$ —	$ *331*
Marketable investments:				
Available-for-sale securities	—	*13,062*	—	*13,062*
Total assets at fair value	$ *331*	$ *13,062*	$ —	$ *13,393*

As of *December 31, 2017,* financial assets measured and recognized at fair value on a recurring basis and classified under the appropriate level of the fair value hierarchy as described above was as follows (in thousands):

December 31, 2017	**Level 1**	**Level 2**	**Level 3**	**Total**
Cash equivalents:				
Money market funds	$ *126*	$—	$ —	$ *126*
Commercial paper	—	—	—	—
Marketable investments:				
Available-for-sale securities	—	*21,728*	—	*21,728*
Total assets at fair value	$ *126*	$ *21,728*	$ —	$ *21,854*

Table of Contents

The Company's Level *1* financial assets are money market funds with fair values that are based on quoted market prices. The Company's Level *2* investments include U.S. government-backed securities and corporate securities that are valued based upon observable inputs that *may* include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, *two*-sided markets, benchmark securities, bids, offers and reference data including market research publications. The average remaining maturity of the Company's Level *2* investments as of *March 31, 2018* is less than *7* months and all of these investments are rated by S&P and Moody's at A or better. The Company recognizes transfers between levels of the fair value hierarchy as of the end of the reporting period. There were *no* transfers within the hierarchy during the quarter and year ended *March 31, 2018* and *December 31, 2017* respectively.

Note 5. Balance Sheet Details

Inventories

As of *March 31, 2018* and *December 31, 2017,* inventories consist of the following (in thousands):

	March 31, 2018	**December 31, 2017**
Raw materials	$*18,735*	$ *19,160*
Work in process	*2,813*	*2,744*
Finished goods	*9,431*	*6,878*
Total	$*30,979*	$ *28,782*

Accrued Liabilities

As of *March 31, 2018* and *December 31, 2017,* accrued liabilities consist of the following (in thousands):

	March 31, 2018	**December 31, 2017**

Accrued payroll and related expenses	$*9,003*	$ *12,567*
Sales and marketing accruals	2,136	*3,710*
Warranty liability	*3,373*	*3,508*
Sales tax	*1,718*	*2,920*
Other	3,853	*4,143*
Total	$20,083	$ *26,848*

Note *6.* Warranty and Service Contracts

The Company has a direct field service organization in the U.S. Internationally, the Company provides direct service support through its wholly-owned subsidiaries in Australia, Belgium, Canada, France, Hong Kong, Japan, and Switzerland, as well as through *third*-party service providers in Spain and the United Kingdom. In several other countries, where it does *not* have a direct presence, the Company provides service through a network of distributors and *third*-party service providers.

After the original warranty period, maintenance and support are offered on a service contract basis or on a time and materials basis. The Company provides for the estimated cost to repair or replace products under warranty at the time of sale. The following table provides the changes in the product warranty accrual for the *three* months ended *March 31, 2018* and *2017* (in thousands):

	Three Months Ended March 31,	
	2018	**2017**
Beginning Balance	$*3,508*	$*2,461*
Add: Accruals for warranties issued during the period	*2,264*	*2,135*
Less: Settlements made during the period	*(2,399*)	*(1,861*)
Ending Balance	$*3,373*	$*2,735*

Table of Contents

Note *7*. Revenue

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for promised goods or services. The Company's performance obligations are satisfied either over time or at a point in time. Revenue from performance obligations that are transferred to customers over time accounted for approximately *14%* of the Company's total revenue for the *three* months ended *March 31, 2018.*

The Company's system sale arrangements generally contain multiple products and services. For these bundled sale arrangements, the Company accounts for individual products and services as separate performance obligations if they are distinct, which is if a product or service is separately identifiable from other items in the bundled package, and if a customer can benefit from it on its own or with other resources that are readily available to the customer. The Company's system sale arrangements include a combination of the following performance obligations: The system and software license (considered as *one* performance obligation), system accessories (hand pieces), training, other accessories, extended service contracts and marketing services.

For the Company's system sale arrangements that include an extended service contract, the period of service commences at the expiration of the Company's standard warranty offered at the time of the system sale. The Company considers the extended service contracts terms in the arrangements that are legally enforceable to be performance obligations. Other than extended contract services and training, the Company satisfies all of the performance obligations at a point in time. System, system accessories (hand pieces), training, and services are also sold on a stand-alone basis, and related performance obligations are satisfied over time as the services are performed. For contracts with multiple performance obligations, the Company allocates the transaction price of the contract to each performance obligation, on a relative basis using its standalone selling price. The stated contract value is the transaction price to be allocated to the separate performance obligations.

Nature of Products and Services

Systems

System revenue represents the sale of a system or an upgrade of an existing system. A system consists of a console that incorporates a universal graphic user interface, a laser and or other energy based module, control system software and high voltage electronics; as well as *one* or more hand pieces. However, depending on the application, the laser or other energy based module is sometimes contained in the hand piece such as with the Company's *Pearl* and *Pearl Fractional* applications instead of within the console.

The Company considers system and software license as *one* performance obligation. The system and the software are highly interrelated and interdependent. Both are necessary for the system to work as designed. The customer cannot benefit from the system without the license to the embedded software. The Company offers customers the ability to select the system that best fits their practice at the time of purchase and then to cost-effectively add applications to their system as their practice grows. This provides customers the flexibility to upgrade their systems whenever they choose and provides us with a source of additional Systems revenue.

The Company considers set-up or installation an immaterial promise as set-up or installation for systems other than *enlighten* system takes only a short time. The related costs to complete set-up or installation are immaterial to the Company. The *enlighten* system includes the related software license as *one* performance obligation and the calibration or installation service as a separate performance obligation since a *third* party could perform this service.

For systems sold directly to end-customers that are credit approved, revenue is recognized when the Company transfers control to the end customer, which occurs when the product is shipped to the customer or when the customer receives the product, depending on the nature of the arrangement. The Company recognizes revenue on cash basis for system sales to other international direct end-customer sales that have not been credit approved, and after satisfying all remaining obligations on the agreement. For systems sold through credit approved distributors, revenue is recognized at the time of shipment. The Company's system arrangements generally do not provide a right of return. The Company provides a standard one-year warranty coverage for all systems sold to end-customers, to cover parts and service, and offer extended service plans that vary by the type of product and the level of service desired.

The Company typically receives payment for its system consoles and other accessories within *30* days of shipment. Certain international distributor arrangements allow for longer payment terms because of the volume of purchases by these distributors.

Table of Contents

Skincare products

The Company sells *third*-party manufactured skincare products in Japan. The Company purchases and inventories these *third*-party skincare products from the manufacturers and sells them to licensed physicians. The Company acts as the principal in this arrangement as it determines the price to charge customers for the skincare products, and controls the products before they are transferred to the customer. The Company warrants that the cosmeceuticals will be free of significant defects in workmanship and materials for *90* days from shipment. Skincare products are typically sold in a separate contract as the only performance obligations. The Company recognizes revenue for skincare products at a point in time, generally upon shipment or delivery.

Consumables (Other accessories)

The Company treats its customer's purchase of replacement *Titan* and *truSculpt 3D* hand pieces as "consumable" revenue, which provides the Company with a source of recurring revenue from existing customers. The Company's recently launched *Juliet* and *Secret RF* products have single use disposable tips which need to be replaced after every treatment. Sale of these consumable tips further enhance the Company's recurring revenue stream. Hand piece refills of the Company's legacy *truSculpt* product are included in the standard warranty and service contract offerings for this product.

Extended contract services

The Company offers post-warranty services to its customers through extended service contracts that cover preventive maintenance and or replacement parts and labor, or by direct billing for detachable hand piece replacements, parts and labor. These post-warranty services serve as additional sources of recurring revenue from the Company's installed product base. Service revenue is recognized over time as the customers benefit from the service throughout the service period. Revenue related to services performed on a time-and-materials basis is recognized when performed. For the Company's performance obligations recognized over time, revenue is generally recognized using a time-based measure of progress reflecting generally consistent efforts to satisfy those performance obligations throughout the arrangement term.

Training

Sales of system to customers include training on the system to be provided within *90* days of purchase. The Company considers training as a separate performance obligation as customers can benefit from readily available resources due to the fact that the customer already has the system. If training occurred before the system was delivered, the customer would *not* have readily available resources and could *not* benefit from the training. Training is also sold separately from the system. This occurs when customers hire new employees and want the Company to train them on a system the customer already owns. The training is useful in providing an enhanced approach to using the System, so the training also has benefit. The Company recognizes revenue for training over time as the training is provided. As training is not required for customers to use the systems, the Company concludes that it has no effect on the Company's evaluation of when the risks and rewards of ownership transfer to customers.

Customer Marketing Support

In North America, the Company offers marketing and consulting phone support to its customers who purchase its *truSculpt 3D* system. This includes a unique marketing program and a customizable practice support kit to help customers inform, inspire and engage their current and prospective patients. This is a personalized program designed to help customers jump-start their practice with *truSculpt 3D.* It includes a business model and marketing training performed remotely with ongoing phone consultations for *six* months from date of purchase.

The Company considers this a separate performance obligation, and allocates and recognizes revenue over the *six*-month term of support. The Company determines the standalone selling price based on cost plus a margin.

Significant Judgments

More judgments and estimates are required under Topic *606* than were required under the previous revenue recognition guidance, Topic 605. Due to the nature of certain contracts, the actual revenue recognition treatment required under Topic *606* for the Company's arrangements *may* be dependent on contract-specific terms and *may* vary in some instances.

Table of Contents

The Company's contract agreement with customers for system purchases includes the delivery of the system and a nonexclusive, nontransferable license to use such software and/or firmware in connection with customer's use of the product. The tangible product, including the embedded software, are delivered to the customer at the time of sale. In some circumstances, in conjunction with the purchase of a system or upgrade, customers purchase service contracts for *one* or more years to cover their products. For these transactions, the following multiple-element arrangement exists: a tangible product delivered to the customer at the inception of the revenue arrangement; and a service contract for delivery of services to the customer over a contractually stated period of time defined in the service contract.

Determining whether licenses and services are distinct performance obligations that should be accounted for separately, or *not* distinct and thus accounted for together, requires significant judgment. The system and the software are highly interrelated and interdependent. Both are necessary for the system to work as designed. The customer cannot benefit from *one* without the other. The Company has concluded that systems and the related software license are *one* performance obligation. The *enlighten* system includes the related software license as *one* performance obligation and the calibration/installation service as a separate performance obligation. The calibration/installation is a separate performance obligation for the *enlighten* system because a knowledgeable *third*-party could perform this service.

The Company has however concluded that set-up or installation for all other systems (excluding the *enlighten* system) is perfunctory as the set-up or installation for systems other than *enlighten* take only a short time, the related costs to complete set-up or installation are immaterial.

Sales of Products to customers include training on the products to be provided within *90* days of purchase. Training is considered a separate performance obligation.

Extended warranty, if included in the agreement, requires the Company to provide extended warranty services for one, *two* or *three* years. The Company considers extended warranty as a separate performance obligation.

Skincare products are typically sold in a separate contract as the only performance obligations.

Judgment is required to determine the standalone selling price ("SSP") for each distinct performance obligation. The Company rarely licenses or sells products on a standalone basis, so the Company estimates SSPs for each performance obligation as follows:

enlighten system: SSP is estimated from observable inputs, if available, and if *not* available, the Company estimates the SSP using cost plus margin.

All other systems: For systems other than *truSculpt 3D* with marketing program, and other marketing support, SSP is estimated from observable inputs, if available, and if *not* available, the Company estimates the SSP using cost plus margin. The Company estimates SSP for *truSculpt 3D* with marketing support using cost plus margin approach; for *truSculpt 3D* without marketing support, the Company estimates SSP from observable inputs, if available, and if *not* available, SSP is estimated using cost plus margin.

Training: SSP is estimated from observable inputs when sold on a standalone basis.

Extended warranty: SSP is estimated from observable inputs when sold on a standalone basis (by customer type).

Marketing program (excluding *third*-party marketing support, which is *not* considered a performance obligation.): SSP is estimated based on cost plus a margin.

Skincare products: Skincare products are the only performance obligation in the contracts. All product is delivered at the same time, therefore the Company does *not* have to allocate the transaction price for skincare products.

The Company allocates transaction price and discount to each performance obligation (i.e., system, extended warranty, training) based on the relative SSP of the performance obligation in the contract.

The Company recognizes revenue for all products (systems, accessories, etc.) at a point in time. The software license embedded in the system is a functional license giving the customer the right to use the software as it exists at the time of shipment. Therefore, revenue related to the software license is recognized at a point in time – upon shipment, and the software license does *not* change the timing of revenue recognition for the system. The Company concluded that it should recognize revenue for extended warranty over the service period on a straight-line basis. The Company also concluded that it should recognize the revenue for the marketing support (excluding *third*-party marketing) over the committed period for the service. The Company plans to use the invoice practical expedient for services provided on a time and materials basis (i.e., recognize the revenue for services as the time and materials are incurred and invoiced to the customer).

The Company will combine *two* or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract. If a group of agreements are so closely related that they are, in effect, part of a single arrangement, such agreements are deemed to be *one* arrangement for revenue recognition purposes. The Company exercises significant judgment to evaluate the relevant facts and circumstances in determining whether the separate agreements should be accounted for separately or as, in substance, a single arrangement. The Company's judgments about whether a group of contracts comprise a single arrangement can affect the allocation of consideration to the distinct performance obligations, which could have an effect on results of operations for the periods involved.

The Company is required to estimate the total consideration expected to be received from contracts with customers. In limited circumstances, the consideration expected to be received is variable based on the specific terms of the contract or based on the Company's expectations of the term of the contract. Generally, the Company has *not* experienced significant returns or refunds to customers. These estimates require significant judgment and the change in these estimates could have an effect on its results of operations during the periods involved.

Contract balance

The Company's service contracts include an upfront payment for the *one*, *two* or *three*-year contract terms. The timing of receipt of payment and timing of performance of the services create timing differences that result in contract liabilities (deferred revenue) on the Company's condensed consolidated balance sheet. The advance payments under these contracts are recorded in deferred revenue (contract liability), and the Company recognizes the revenue on a straight-line basis over the period of the applicable contract. Contracted but unsatisfied performance obligations were approximately $11.0 million as of March 31, 2018, of which the Company expects to recognize approximately 80% of the revenue over the next 12 months and the remainder thereafter.

Deferred Sales Commissions

The Company records a contract asset for the incremental costs of obtaining a contract with a customer, including direct sales commissions that are earned upon execution of the contract for its post-warranty service contracts that are capitalized and amortized over the estimated customer relationship period.

The Company uses the portfolio method to capitalize and recognize the amortization expense related to these capitalized costs related to initial contracts and renewals and such expense is recognized over a period associated with the revenue of the related portfolio, which is generally *two* to *three* years for the Company's product and service arrangements. The Company determined that it would apply the *one*-year practical expedient to sales commissions on systems sales and training because the revenue for these items would be recognized at a point in time (systems) or shortly after the sale is completed (training).

Incremental costs related to initial contracts and renewals are amortized over the same period because the commissions paid on both the initial contract and renewals are commensurate with *one* another. Total capitalized costs as of *March 31, 2018* were *$4.9* million and are included in other assets in the Company's condensed consolidated balance sheet. Amortization of these assets was *$0.4* million during the *three* months ended *March 31, 2018* and is included in sales and marketing expense in the Company's condensed consolidated income statement.

Note *8*. Deferred Service Contract Revenue

The Company generates Service revenue from the sale of extended service contracts and from time and material services provided to customers who are *not* under a warranty or extended service contract. Service contract revenue is recognized on a straight-line basis over the period of the applicable contract. Service revenue from time and material services is recognized as the services are provided.

The following table provides changes in the deferred service contract revenue balance for the *three* months ended *March 31, 2018* and *2017* (in thousands):

	Three Months Ended March 31,	
	2018	**2017**
Beginning Balance	$*10,719*	$*9,431*
Add: Payments received	*2,995*	*3,391*
Less: Revenue recognized	*(3,347*)	*(3,267*)
Ending Balance	$*10,367*	$*9,555*

Costs for extended service contracts were *$1.9* million for the *three* months ended *March 31, 2018* and *2017,* respectively.

*The Company recognized $0.8 million related to training, marketing assistance and installation for the *enlighten* system related to revenue deferred in 2017 and recognized during the first quarter of 2018.

17

Note *9.* Stockholders' Equity and Stock-based Compensation Expense

In *1998,* the Company adopted the *1998* Stock Plan, or *1998* Plan, under which *4,650,000* shares of the Company's common stock were reserved for issuance to employees, directors and consultants. On *January 12, 2004,* the Board of Directors adopted the *2004* Equity Incentive Plan. A total of *1,750,000* shares of common stock were originally reserved for issuance pursuant to the *2004* Equity Incentive Plan. In addition, the shares reserved for issuance under the *2004* Equity Incentive Plan included shares reserved but un-issued under the *1998* Plan and shares returned to the *1998* Plan as the result of termination of options or the repurchase of shares. In *2012* the stockholders approved a "fungible share" provision whereby each full-value award issued under the *2004* Equity Incentive Plan results in a requirement to subtract *2.12* shares from the shares reserved under the Plan.

Activity under the Company's *2004* Equity Incentive Plan, as amended, is summarized as follows:

		Options Outstanding	
	Shares Available for Grant	**Number of Stock Options Outstanding**	**Weighted-Average Exercise Price**
Balance, December 31, 2017	*1,494,866*	*839,919*	$ *16.46*
Options granted	*(14,500)*	*14,500*	*53.90*
Stock awards granted(1)	*(310,275)*	—	—
Options exercised	—	*(66,167)*	*9.57*
Options canceled	*32,438*	*(32,438)*	*15.87*
Stock awards canceled(1)	*43,990*	—	—
Balance, March 31, 2018	*1,246,519*	*755,814*	$ *17.81*

(1) The Company has a "fungible share" provision in its 2004 Equity Incentive Plan whereby for each full-value award (RSU/PSU) issued or canceled under the Plan requires the subtraction or add back of 2.12 shares from or to the Shares Available for Grant, respectively.

Under the *2004* Equity Incentive Plan, as amended, the Company issued *156,181* shares of common stock during the *three* months ended *March 31, 2018,* in conjunction with stock options exercised and the vesting of RSUs and PSUs.

As of *March 31, 2018,* there was approximately *$15.7* million of unrecognized compensation expense, net of projected forfeitures, for stock options and stock awards. The expense is expected to be recognized over the remaining weighted-average period of *2.51* years. The actual expense recorded in the future *may* be higher or lower based on a number of factors, including, actual forfeitures experienced and the degree of achievement of the performance goals related to the PSUs granted.

2004 Employee Stock Purchase Plan

On *January 12, 2004,* the Board of Directors adopted the *2004* Employee Stock Purchase Plan. Under the *2004* Employee Stock Purchase Plan, or *2004* ESPP, eligible employees are permitted to purchase common stock at a discount through payroll deductions. The *2004* ESPP offering and purchase periods are for approximately *six* months. The *2004* ESPP has an evergreen provision based on which shares of common stock eligible for purchase are increased on the *first* day of each fiscal year by an amount equal to the lesser of:

i. *600,000* shares;

ii. *2.0%* of the outstanding shares of common stock on such date; or

iii. an amount as determined by the Board of Directors.

Non-Employee Stock-Based Compensation

The Company granted 1,640 RSUs and 1,640 PSUs to *one* non-employee during the quarter ended *March 31, 2018,* and *7,745* stock options and *2,478* RSUs during the year ended *December 31, 2017.* The *7,745* stock options vests over *4* years at *25%* on the *first* anniversary of the grant date and *1/48th* each month thereafter.

The 4,118 RSUs vests over *4* years at *25%* each anniversary of the grant date, whiles the 1,640 PSUs vesting is subject to the recipient's continued service and achievement of pre-established goals. These RSUs/PSUs and stock options were granted in exchange for consulting services to be rendered and are measured and recognized as they are earned. The Company revalues stock options granted to non-employees at each reporting date as the underlying equity instruments vest.

Table of Contents

Stock-based Compensation Expense

Stock-based compensation expense by department recognized during the *three* months ended *March 31, 2018* and *2017* were as follows (in thousands):

	Three Months Ended March 31,	
	2018	**2017**
Cost of revenue	$*154*	$*129*
Sales and marketing		
Employee	*452*	*420*
Non-employee	*37*	-
Research and development	*191*	*237*
General and administrative	*854*	*609*
Total stock-based compensation expense	$*1,688*	$*1,395*

Note *10*. Net Loss Per Share

Basic net income (loss) per share is computed using the weighted-average number of shares outstanding during the period. In periods of net income, diluted shares outstanding include the dilutive effect of in-the-money equity awards (stock options, restricted stock units, performance stock units and employee stock purchase plan contributions), which is calculated based on the average share price for each fiscal period using the treasury stock method. In accordance with ASC *718,* the assumed proceeds under the treasury stock method include the average unrecognized compensation expense of in-the money stock options and restricted stock units. This results in the assumed buyback of additional shares, thereby reducing the dilutive impact of equity awards.

Diluted earnings per share is the same as basic earnings per share for the periods in which the Company had a net loss because the inclusion of outstanding common stock equivalents would be anti-dilutive.

The following table sets forth the computation of basic and diluted net income (loss) and the weighted average number of shares used in computing basic and diluted net income (loss) per share (in thousands, except per share data):

	Three months ended March 31, 2018	**Three months ended March 31, 2017**
Numerator:		
Net loss	$*(2,032*)	$*(1,022*)
Denominator:		
Weighted-average shares outstanding in basic calculation	*13,587*	*13,840*
Add: dilutive effect of potential common shares	—	—
Weighted-average shares used in computing diluted net income per share	*13,587*	*13,840*
Net loss per share:		
Net loss per share, basic and diluted	$*(0.15*)	$*(0.07*)

Basic net loss per share is calculated by dividing net loss by the weighted-average number of common shares outstanding during the year. Diluted net loss per common share is the same as basic net loss per common share, as the effect of the potential common stock equivalents is anti-dilutive and as such is excluded from the calculations of the diluted net loss per share.

Table of Contents

The following numbers of shares outstanding, prior to the application of the treasury stock method, were excluded from the computation of diluted net loss per common share for the period presented because including them would have had an anti-dilutive effect (in thousands):

	Three Months Ended March 31,	
	2018	**2017**
Options to purchase common stock	*807*	*1,088*
Restricted stock units	*396*	*384*
Performance stock units	*23*	*164*
Employee stock purchase plan shares	*34*	*49*
Total	*1,260*	*1,685*

Note *11*. Income Taxes

The Company calculates the provision for income taxes during interim reporting periods by applying an estimate of the annual effective tax rate for the full year to "ordinary" income or loss (pretax income or loss excluding unusual or infrequently occurring discrete items) for the reporting period. When applicable, the year-to-date tax provision reflects adjustments from discrete tax items. The income tax benefit for the *three* months ended *March 31, 2018* reflects a projected income tax expense for U.S. and non-U.S. operations resulting in an annual effective tax rate applied to the year-to-date ordinary loss. This tax benefit is increased by excess tax benefit generated by stock deductions exercised or vested in the *three* months ended *March 31, 2018.* For the *three* months ended *March 31, 2018,* the Company's income tax benefit was *$2,619,000,* compared to a tax benefit of *$118,000* for the same period in *2017.* The income tax benefit for the *three* months ended *March 31, 2018* includes a tax benefit for excess tax deductions of approximately *$1,460,000,* recorded discretely in the reporting period.

The Company utilizes the asset and liability method of accounting for income taxes, under which deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using enacted tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance is recorded when it is more likely than *not* that some of the deferred tax assets will *not* be realized. As of *December 31, 2017,* the Company released its valuation allowance against U.S. Federal and all other domestic state net deferred tax assets except for California and Massachusetts. The Company maintained this valuation allowance position through *March 31, 2018.* Significant management judgment is required in determining any valuation allowance recorded against deferred tax assets. In evaluating the ability to recover deferred tax assets, the Company considered available positive and negative evidence giving greater weight to its recent cumulative profits and lesser weight to its projected financial results due to the subjectivity involved in forecasting future periods. The Company also considered, commensurate with its objective verifiability, the forecast of future taxable income including the reversal of temporary differences, the implementation of feasible and prudent tax planning strategies and the impact of the Tax Cuts and Jobs Act of *2017* (the *"2017* Tax Act").

Note 12. Segment reporting

Segment reporting is based on the "management approach," following the method that management organizes the company's reportable segments for which separate financial information is made available to, and evaluated regularly by, the chief operating decision maker in allocating resources and in assessing performance. The Company's chief operating decision maker ("CODM") is its CEO, and makes decision on allocating resources and in assessing performance. The CODM reviews the Company's consolidated results as one operating segment. In making operating decisions, the CEO primarily considers consolidated financial information, accompanied by disaggregated information about revenues by geography and product. All of the Company's principal operations and decision-making functions are located in the United States. The Company's chief operating decision maker viewed its operations, managed its business, and used *one* measurement of profitability for the *one* operating segment - which sells aesthetic medical equipment and services, and distributes skincare products, to qualified medical practitioners. Substantially all of the Company's long-lived assets are located in the U.S.

The following table presents a summary of revenue by geography for the three months ended March 31, 2018 and 2017:

	Three Months Ended	
	March 31,	
Revenue mix by geography:	**2018**	**2017**
United States	$ 21,136	$ 16,544
Japan	3,555	3,880
Asia, excluding Japan	2,843	3,184
Europe	2,570	2,225
Rest of the world	4,021	3,466
Total consolidaed revenue	$34,125	$29,299
Revenue mix by product category:		
Products	$ 27,239	$ 22,992
Consumables (Hand Piece Refills)	769	499
Skincare	1,256	984