

BSML INC  
Form 10-Q  
May 21, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

**For the Quarterly Period Ended: March 31, 2007**

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

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

**Commission File Number: 1-11064**

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**BSML, INC.**

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

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**UTAH**  
**(State or other jurisdiction of**  
  
**incorporation or organization)**

**87-0410364**  
**(IRS employer**  
  
**identification no.)**

**460 North Wiget Lane**  
  
**Walnut Creek, California**

**94598**

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(Address of principal executive offices)

(925) 941-6260

(Zip Code)

(Issuer's telephone number, including area code)

**Former name: BriteSmile, Inc.**

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

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ 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 ☐ 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 ☒ No ☐

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 a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

BSML, Inc. had 10,744,281 shares of common stock outstanding at March 31, 2007.

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**BSML, INC. AND SUBSIDIARIES**

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**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****BSML, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(\$ in thousands, except share data)

	<b>March 31, 2007 (Unaudited)</b>	<b>December 30, 2006</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 3,468	\$ 4,734
Trade accounts receivable, net	445	213
Inventories	1,084	1,273
Investments, restricted as to use	3,666	3,625
Prepaid expenses and other current assets	273	243
Total current assets	8,936	10,088
Property and equipment, net	3,896	4,258
Investments, restricted as to use	2,681	2,761
Other assets	969	958
Total assets	\$ 16,482	\$ 18,065
<b>LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)</b>		
Current liabilities:		
Accounts payable	\$ 1,287	\$ 1,770
Accrued liabilities	6,195	6,776
Accrual for Center closures	266	170
Gift certificate liability	1,456	1,775
Deferred revenue	2,819	2,590
Total current liabilities	12,023	13,081
Long term liabilities:		
Accrual for Center closures	134	258
Deferred revenue	1,159	1,352
Other long term liabilities	841	892
Total long term liabilities	2,134	2,502
Total liabilities	14,157	15,583
Shareholders' equity:		
Common stock, \$0.001 par value, 50,000,000 shares authorized, 10,744,281 and 10,664,281 shares issued and outstanding at March 31, 2007 and December 30, 2006, respectively	39	39

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Preferred stock, no par value, 5,000,000 shares authorized, none outstanding at March 31, 2007 and December 30, 2006		
Additional paid-in capital	174,134	173,903
Accumulated deficit	(171,848)	(171,460)
 Total shareholders' equity	 2,325	 2,482
 Total liabilities and shareholders' equity	 \$ 16,482	 \$ 18,065

See notes to condensed consolidated financial statements.

**Table of Contents****BSML, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(unaudited)****(\$ in thousands, except share data)**

	<b>13 Weeks Ended March 31, 2007</b>	<b>13 Weeks Ended April 1, 2006 (restated)</b>
Revenues	\$ 7,161	\$ 6,035
Operating costs and expenses:		
Operating and occupancy costs	3,644	3,338
Selling, general and administrative expenses	3,666	5,336
Depreciation and amortization	362	107
Total operating costs and expenses	7,672	8,781
Loss from operations	(511)	(2,746)
Amortization of discount on debt		(530)
Loss on early extinguishment of debt		(5,039)
Other income / (expense), net	141	(964)
Loss from continuing operations before income tax provision	(370)	(9,279)
Income tax provision	18	35
Net loss from continuing operations	(388)	(9,314)
Discontinued operations (Note 3):		
Income from discontinued operations, net of tax (thirteen weeks ended April 1, 2006, includes gain from sale of business of \$15,794, net of tax, and gain on settlement of litigation of \$5,202, net of tax)		20,996
Net income (loss) attributable to common shareholders	\$ (388)	\$ 11,682
Basic and diluted net loss per common share from continuing operations	\$ (0.04)	\$ (0.88)
Basic net income (loss) per common share from discontinued operations	\$	\$ 1.99
Diluted net income (loss) per common share from discontinued operations	\$	\$ 1.99
Basic net income (loss) per common share	\$ (0.04)	\$ 1.11
Diluted net income (loss) per common share	\$ (0.04)	\$ 1.11
Shares used in computing net loss per common share from continuing operations, basic and diluted	10,717,614	10,549,130
Shares used in computing net income per common share from discontinued operations, basic	10,717,614	10,549,130
Shares used in computing net income (loss) per common share from discontinued operations, diluted	10,717,614	10,555,130

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Shares used in computing net income (loss) per common share, basic	10,717,614	10,549,130
Shares used in computing net income (loss) per common share, diluted	10,717,614	10,555,130

See notes to condensed consolidated financial statements.

**Table of Contents****BSML, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****Unaudited**

(\$ in thousands, except share data)

	<b>13 Weeks Ended March 31, 2007</b>	<b>13 Weeks Ended April 1, 2006 (restated)</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ (388)	\$ 11,682
Adjustments to reconcile to net cash provided by (used in) operating activities:		
Depreciation and amortization	362	107
Loss on disposal of property and equipment		3
Amortization of discount on debt		530
Gain on sale of discontinued operations		(20,996)
Loss on early extinguishment of debt		5,039
Stock compensation expense	231	75
Expenses paid by related party		20
Changes in assets and liabilities:		
Trade accounts receivable	(232)	(468)
Inventories	189	171
Prepaid expenses and other	(30)	688
Other assets	(11)	(24)
Accounts payable	(483)	329
Accrued liabilities	(581)	1,182
Gift certificate and prepaid appointment deferred revenue	(319)	(218)
Store closure accrual	(28)	(55)
Maintenance contract deferred revenue	36	(309)
Other long term liabilities	(51)	357
Net cash provided by operating activities discontinued operations		9,836
Net cash provided by (used in) operating activities	(1,305)	7,949
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from assets held for sale discontinued operations		25,831
Investments, restricted as to use	39	(10,995)
Proceeds from sale of investment		138
Net cash used in investing activities	39	14,974
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Payments of capital lease obligation		(73)
Principal payments on long-term debt		(19,051)
Net cash provided by (used in) financing activities		(19,124)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,266)	3,799
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD	4,734	5,518
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD	\$ 3,468	\$ 9,317



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### SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash paid for interest	\$		\$	898
Cash paid for income taxes	\$	308	\$	78

See notes to condensed consolidated financial statements.

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**BSML, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. Description of Business and Basis of Presentation**

**Description of Business and Basis of Presentation**

BSML, Inc. is a Utah corporation ( "BSML" or the "Company" ) formerly known as BriteSmile, Inc. The Company and its affiliates develop, distribute, market and sell advanced teeth whitening technology, products, systems and services. 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" ). Prior to March 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" ). As described below, the Company's Associated Center business was sold in March 2006. The results of operations of the Associated Centers business, the gain on sale of assets of the Associated Centers business and the gain on settlement of litigation related to the sale have been classified as discontinued operations in all 2006 periods presented in this quarterly report on Form 10 Q. The Company's business is now focused on one industry segment: products and procedures to whiten teeth.

As of December 31, 2005, the Company had an agreement with Dental Spas, Inc. to sell its Centers business, but this agreement was terminated on May 1, 2006. Since the agreement with Dental Spas to sell the Centers business was terminated 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 for use. The continuing operations in the financial statements consist of sales, costs of sales and operating expenses of our Centers business, including our corporate expenses. In March 2006, we completed the sale of our Associated Centers business. The financial data of the Associated Centers has been prepared in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Accordingly, the results of operations for the Associated Centers for all periods presented have been reflected as discontinued operations. There are no assets or liabilities of the Associated Centers business as of April 1, 2006, or subsequently.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions in Form 10-Q and Article 10 of Regulations S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the 13 weeks ended March 31, 2007 are not necessarily indicative of the results that may be expected for the remainder of the Company's fiscal year ending December 29, 2007.

**Going Concern**

To date, the Company has yet to achieve profitability. The Company has an accumulated deficit of \$171,848,000 and working capital deficiency of \$3,087,000 as of March 31, 2007. The Company's net loss and net cash used by operating activities were \$388,000 and \$1,305,000, respectively, for the thirteen weeks ended March 31, 2007. At March 31, 2007, the Company had \$3.5 million in unrestricted cash and cash equivalents. 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. The Company is not certain if its cash will be sufficient to maintain operations of the continuing company at least through the next year due to the uncertainty surrounding the outcome of legal claims against the Company and the uncertainty of the Company's ability to generate positive cash flow from the Centers business operations.

While the financial results and statements have been presented assuming discontinuation of operations consistent with FAS 144 impairment analysis, the financial statements otherwise reflect a going concern basis of accounting. The Company cannot currently provide assurance that it can become profitable. If it cannot become profitable, and without additional financing, which may be impossible to secure, the Company may not have sufficient liquidity to support its operating requirements through 2007. In addition, it is possible that the Company will have additional cash demands as a result of unfavorable outcomes in pending litigation matters. Accordingly, BSML management believes that these factors raise substantial 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. The accompanying financial statements do not

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include any adjustments that may be necessary if the Company unable to continue as a going concern.

**Table of Contents*****Recent Accounting Pronouncements***

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ). SFAS 159 provides that companies may elect to measure specified financial instruments and warranty and insurance contracts at fair value on a contract-by-contract basis, with changes in fair value recognized in earnings each reporting period. The election, called the fair value option, will enable some companies to reduce the variability in reported earnings caused by measuring related assets and liabilities differently. Companies may elect fair-value measurement when an eligible asset or liability is initially recognized or when an event, such as a business combination, triggers a new basis of accounting for that asset or liability. The election is irrevocable for every contract chosen to be measured at fair value and must be applied to an entire contract, not to only specified risks, specific cash flows, or portions of that contract. SFAS 159 is effective as of the beginning of a company's first fiscal year that begins after November 15, 2007. Retrospective application is not allowed. Companies may adopt SFAS 159 as of the beginning of a fiscal year that begins on or before November 15, 2007 if the choice to adopt early is made after SFAS 159 has been issued and within 120 days of the beginning of the fiscal year of adoption and the entity has not issued GAAP financial statements for any interim period of the fiscal year that includes the early adoption date. Companies are permitted to elect fair-value measurement for any eligible item within SFAS 159's scope at the date they initially adopt SFAS 159. The adjustment to reflect the difference between the fair value and the current carrying amount of the assets and liabilities for which a company elects fair-value measurement is reported as a cumulative-effect adjustment to the opening balance of retained earnings upon adoption. Companies that adopt SFAS 159 early must also adopt all of SFAS 157's requirements at the early adoption date. Management is assessing the impact of adopting SFAS 159 and currently does not believe the adoption will have a material impact on our financial position, cash flows or results of operations.

In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 158. SFAS No. 158 requires an employer to recognize the over-funded or under-funded status of a defined benefit post-retirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position as of the statement date and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. SFAS No. 158 will become effective for fiscal years ending after December 15, 2008 and is will not be applied retroactively. The Company has evaluated SFAS No. 158 and does not believe its adoption will have a significant result on its results of operations or financial condition.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; rather, it applies under other accounting pronouncements that require or permit fair value measurements. The provisions of SFAS No. 157 are effective for fiscal years beginning after November 15, 2007. The Company has evaluated SFAS No. 157 and does not believe its adoption will have a significant result on its results of operations or financial condition.

From time to time, new accounting pronouncements are issued by FASB that are adopted by the Company as of the specified effective date. Unless otherwise discussed, the Company believes that the impact of recently issued standards, which are not yet effective, will not have a material impact on the Company's consolidated financial statements upon adoption.

**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.

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 13-weeks period ended March 31, 2007 and April 1, 2006, the Company recognized stock-compensation costs of approximately \$231,000 and \$75,000, respectively. Of the \$231,000 recognized in the 13-week period ended March 31, 2007, approximately \$140,000 had been previously accrued as an expense related to an expected legal settlement; this amount was reclassified to stock-compensation expense in the first quarter of 2007 matching the period of final settlement and issuance of shares. The Company recognized no 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.



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Based on current assumptions, currently outstanding option grants and restricted common shares expected to vest and become unrestricted in the future, the remaining value as stock-compensation cost in the future is approximately \$489,000.

The following table represents stock option activity for the 13 week period ended March 31, 2007:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In thousands)
Options outstanding at December 30, 2006	487,490	\$ 13.88		
Granted	40,000	1.77		
Exercised				
Cancelled	(35,377)	14.26		
Options outstanding at March 31, 2007	492,113	\$ 12.87	3.2 years	\$ 12
Vested or expected to vest at March 31, 2007	488,779	\$ 13.41	3.4 years	\$ 12
Exercisable at March 31, 2007	468,695	\$ 13.41	3.0 years	\$ 12

The Company has made no stock-based compensation awards to employees in 2007. The Company's stock-based compensation expense for the thirteen weeks ended March 31, 2007 is entirely due to employee stock and stock-based awards made prior to the beginning of the Company's fiscal 2007 year, 40,000 options awarded to directors and to an immediately vested stock award made to a non-employee. The Company's estimated future stock-based compensation expense is primarily due to a restricted stock grant made to the Company's Chief Executive Officer in 2006 and to the unvested portion of option grants made to directors in the first quarter of 2007. For options granted in the thirteen week periods ended March 31, 2007, and April 1, 2006, respectively, the Company used the Black-Scholes option pricing model to estimate the fair value of employee stock-based awards with the following assumptions:

	13 Weeks Ended March 31, 2007	13 Weeks Ended April 1, 2006
Risk-free interest rate	4.61%	4.37%
Expected life of options (yrs)	2.66	2.66
Expected volatility	121%	121%
Expected dividends	None	None
Forfeiture rate	10%	27%

The assumptions above are based on multiple factors, including historical exercise patterns of employees. We used 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 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 was based on the U.S. Treasury yield curve.

In the fourth quarter of 2006, the Company awarded its Chief Executive Officer 574,290 shares of restricted stock. Twenty percent of the shares vested immediately as of his employment date and additional amounts of twenty percent of the total grant will vest on each of the next four anniversaries of his employment date. An assumed annual forfeiture rate of 10% has been used in determining the current period expense associated with this grant and the future expected expense associated with this grant. 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.

**3. Income/Loss Per Common Share**

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Basic net income/loss per share is calculated as net income/loss divided by the weighted-average number of common shares outstanding. For the 13-week period ended April 1, 2006, there were 6,000 stock options included in the calculation of diluted net income per share, as their effect was 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:

	<b>March 31, 2007</b>	<b>April 1, 2006</b>
Potentially dilutive securities:		
Options	492,113	1,001,291
Warrants	354,551	930,155
Total	846,664	1,931,446

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### **4. Discontinued Operations**

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), where Discus acquired the assets and the operations of the Company's Associated Centers business for approximately \$26.8 million plus the assumption of certain operating liabilities. The assets sold to Discus include certain of our tangible assets and proprietary rights related to the Associated Centers Business, including the BriteSmile name and trademark, and substantially all of our intellectual property rights. Discus acquired our intellectual property subject to certain existing technology and trademark licenses in favor of Sellers that permit the operation of the Centers business of the Sellers and sales of certain retail products under the BriteSmile trademark. Discus also acquired all of our rights and claims against third parties relating to the intellectual property, except for our claims against third parties who may have infringed certain patents in the whitening strips field, which we retained under a license from Discus. In the same transaction, the Company settled its litigation with Discus for \$8.7 million. All litigation between the Company and Discus has now been dismissed. The asset sale and settlement of litigation resulting in total consideration of approximately \$35.5 million to the Company, prior to consideration of related deal costs, legal expenses and income taxes. In the statement of operations for the period ended April 1, 2006, the operations of the Associated Centers have 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.

As of December 31, 2005, the Company had an agreement with Dental Spas, Inc. to sell its Centers business, but this agreement was terminated on May 1, 2006. Since the agreement with Dental Spas to sell the Centers business was terminated 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 for use. The continuing operations in the financial statements consist of sales, costs of sales and operating expenses of our Centers business, including our corporate expenses. In March 2006, we completed the sale of our Associated Centers business. The financial data of the Associated Centers has been prepared in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Accordingly, the results of operations for the Associated Centers for all periods presented have been reflected as discontinued operations. There are no assets or liabilities of the Associated Centers business as of April 1, 2006, or subsequently.

For the thirteen-week period ended April 1, 2006 revenues from discontinued operation were approximately \$3.0 million and net income from discontinued operations was \$1.1 million. Also for the thirteen-week period ended April 1, 2006, the after-tax gain on the sale of assets was \$14.7 million, income from operations was \$1.1 million and the after-tax gain on settlement of litigation was \$5.2 million, for total income from discontinued operations, net of tax, of \$21.0 million. Subsequently, in the third quarter of 2006, the gain on sale of assets and the gain on settlement were revised to reflect additional legal expenses incurred. In the fourth quarter of 2006, these gains were further revised to reflect adjustments in estimated taxes due on the transaction.

### **5. Debt**

The Company utilized proceeds received from selling its Associated Centers business in March 2006 to pay off all long-term debt and capital leases existing at that time. These payments totaled approximately \$19.1 million. The Company had no debt at December 30, 2006 or March 31, 2007.

### **6. Related Party Payments**

The following table summarizes the amounts paid to related parties in the thirteen-week periods ended March 31, 2007 and April 1, 2006, respectively:



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Related Party	Nature of Relationship	Goods / Services		13 Weeks Ended March 31, 2007	13 Weeks Ended April 1, 2006
		Provided			
Oraceutical, LLC	A former board member is a co-founder and managing director	Merchandise/Pack out charges and order fulfillment services	\$ 299,843	\$ 907,000	
Oraceutical, LLC	A former board member is a co-founder and managing director	Consulting	45,000	45,000	
LCO Properties, Inc.	Deemed affiliate of the chairman of the board	Monthly rent for New York Center	126,935	123,000	
LCO Investments Limited	Deemed affiliate of the chairman of the board	Interest and pay off of debt and pay out for preferred stock		3,306,000	
CAP America Trust	Deemed affiliate of the chairman of the board	Interest and pay off of debt		1,582,000	
Excimer Vision Leasing	Deemed affiliate of the chairman of the board	Variable fees, fixed fees, pay off of deferred lease balance		2,867,000	
Total			\$ 471,778	\$ 8,830,000	

Oraceutical, LLC supplies the Company with approximately 20% of its product, valued at cost.

**6. 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.

A summary of legal matters settled or dismissed prior to March 31, 2007 is provided in the Company's annual report on Form 10-K for the year ended December 30, 2006.

The following cases or claims remain active and pending against the Company:

*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.

During multi-day hearings held on October, November and December of 2006, the court heard arguments and granted in part the Company's motion for summary judgment dismissing Smile's claims for conversion, unjust enrichment, civil conspiracy, interference with contractual and

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economic relations and constructive trust as a claim. In addition, the court ruled that Smile is not entitled to recover the approximately \$2.4 million in prejudgment interest that it was seeking to recover.

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On February 28, 2007, the court held the first day of an evidentiary hearing regarding the reliability of Smile's expert witness testimony on lost profits damages.

The Company is subject to a prejudgment writ of attachment in the amount of \$1.5 million based on a stipulation of the parties. No trial date is currently set.

*Claims of Oraceutical LLC, Oraceutical Innovative Properties LLC, and R. Eric Montgomery.* In April 2007, Oraceutical LLC, Oraceutical Innovative Properties LLC, and R. Eric Montgomery (collectively, "Oraceutical") filed suit in California state court naming as defendants the Company and its subsidiary BriteSmile Development, Inc. ("BDI"), the Company's Chief Executive Officer, Dr. Julian C. Feneley ("Feneley"), and the Company's Chairman of the Board, Mr. Anthony M. Pilaro ("Pilaro"). The complaint also names as defendants Discus Dental, Inc. and its subsidiary BriteSmile Professional, Inc. (collectively, "Discus"), neither of whom is affiliated with the Company. The complaint seeks to recover at least \$11.3 million plus punitive and exemplary damages. The complaint asserts claims against the Company and BDI for breach of contract, breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty, unjust enrichment, fraud, violations of California Business & Professions Code § 17200 et seq., and accounting, and asserts a fraud claim against Feneley and Pilaro. The complaint also includes a declaratory judgment claim against the Company, BDI, and Discus.

The claims in the complaint are based on an Asset Purchase Agreement, as subsequently amended (the "APA"), entered into between Oraceutical, the Company and BDI in July 2003. Pursuant to the APA, 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.

In March 2006, the intellectual property acquired from Oraceutical was sold to Discus along with other assets of the Company in a transaction valued at \$35 million, with \$8.7 million allocated to settle patent infringement litigation with Discus. In the complaint Oraceutical claims that that value of the patent infringement settlement should be substantially more than \$8.7 million. If the value was \$8.7 million, and after considering appropriate off-sets and deductions required by the APA, Oraceutical would not be entitled to any part of the consideration received from Discus. The declaratory judgment claim seeks a declaration that Discus should be bound by the terms of the APA as the party who acquired the subject intellectual property from BDI.

A response to the complaint is not yet due. The Company intends to respond to the complaint on or before the due date and will vigorously contest all claims. Among other defenses, the Company will present substantial evidence concerning the \$26.8 million value of the assets acquired by Discus and the \$8.7 million value of the Discus patent litigation settlement, including opinions of the Company's investment banker in the Discus transaction, Piper Jaffray.

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.

## 7. Product line revenues

The Company operates in one business segment, products and procedures to whiten teeth. Components of the Company's revenue for the thirteen-month periods ended March 31, 2007 and April 1, 2006, respectively, are as follows (in thousands):

	Thirteen months ended	
	March 31, 2007	April 1, 2006
Center whitening fees, net	\$ 4,651	\$ 4,513
Product and other revenue	2,510	1,522
<b>Total</b>	<b>\$ 7,161</b>	<b>\$ 6,035</b>

**Table of Contents****8. Commitments and contingencies**

The following table sets forth the Company's future minimum payments due under operating leases, consulting agreements and office equipment service agreements:

	Total	Payments Due by Period (in thousands)			
		Remaining 2007 (Nine Months)	2008-2009	2010-2011	2012 and Thereafter
<b>Contractual obligations:</b>					
Operating leases	\$ 10,433	\$ 2,831	\$ 6,450	\$ 695	\$ 457
Consulting and office equipment service contracts	382	156	202	19	5
<b>Total</b>	<b>\$ 10,815</b>	<b>\$ 2,987</b>	<b>\$ 6,652</b>	<b>\$ 714</b>	<b>\$ 462</b>

**9. Significant Customer**

The Company has one customer, the QVC Network, which comprised more than 10% of the company's revenues for the three months ended March 31, 2007, as follows (in thousands):

	13 Weeks ended March 31, 2007	13 Weeks ended April 1, 2006
QVC Network revenue	\$ 799	\$ 503
Other revenue	6,362	5,532
<b>Total Revenue</b>	<b>\$ 7,161</b>	<b>\$ 6,035</b>

**10. Compliance with SFAS Interpretation 48, Accounting for Uncertainty in Income Taxes**

The Company adopted SFAS Interpretation 48, *Accounting for Uncertainty in Income Taxes*, or FIN 48, on January 1, 2007. Management's review of its inventory of tax positions indicated two positions that are judged not to meet the standard of "more likely than not" to be upheld upon audit. Specifically, the Company's treatment of gift certificate revenue and maintenance contract revenue has mirrored the requirements for revenue recognition under generally accepted accounting principles, whereas provisions of the tax code may require cash basis recognition of income. This distinction will create a timing difference between periods in which revenue is to be recognized in our financial statements compared with periods in which revenue is to be recognized on the Company's tax returns. However, these positions would not require a FIN 48 reserve as the net operating loss deduction would offset any additional income recognition and FIN 48 allows the netting of the reserve against the NOL deferred tax asset. As the deferred tax asset is fully offset by a valuation allowance, recording a reserve would represent a reclass between the reserve and the valuation allowance and would not have an impact to our financial statements. As we did not recognize any adjustment to the liability for uncertain tax positions nor did we record any unrecognized tax benefits, no adjustments were recorded to the beginning balance of retained earnings on the balance sheet.

The Company files income tax returns in the U.S. federal jurisdiction and in the state of California. Our centers, which operate as professional corporations, also file federal income tax returns and state income tax returns in their respective states.

The Company has elected to record interest and penalties recognized in accordance with FIN 48 in the financial statements as a component of income tax expense. Any subsequent change in classification of interest and penalties will be treated as a change in accounting principle subject to the requirements of Statement of Financial Accounting Standards (SFAS) No. 154, *Accounting Changes and Error Corrections*.

**Note 11. Reclassification and restatement of Condensed Consolidated Statement of Operations and Condensed Consolidated Statement of Cash Flows for the thirteen weeks ended April 1, 2006**

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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, in the Company's quarterly report on Form 10-Q for the thirteen week period ended April 1, 2006, the operations of the Associated Centers and the Centers were 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.

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On March 13, 2006, BriteSmile completed an asset sale with Discus, whereby Discus acquired the assets and the operations of the Associated Centers. During the first quarter of 2006, Dental Spas agreed to purchase the Company's Centers business. However, on May 1, 2006, the closing conditions set forth in the Purchase Agreement with Dental Spas 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. Therefore, the financial statements included in annual report on Form 10Q for the quarterly period ended July 1, 2006, and all reports thereafter, were prepared in accordance with the Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets in that the results of operations for the Centers business were presented as continuing operations for all periods presented. Reclassifications to the results of the Centers business, reported as discontinued in the quarterly report on Form 10-Q for the period ended April 1, 2006, were made as required in order to effect their presentation as from continuing operations in all periods including and subsequent to July 1, 2006. All assets and liabilities related to the discontinued operations of the Associated Centers business were classified as held for sale for all comparative reporting periods presented.

Additionally, the Company subsequently changed the method used in determination of income (loss) from discontinued operations for its fiscal year ended December 30, 2006 and for the each of the fiscal quarters of 2006. This requires of restatement of income (loss) from continuing and discontinued operations for those periods, although revenue and net income are not affected. A summary of the changes are presented below:

	13 Weeks Ended April 1, 2006*	Reclassification per SFAS 144	13 Weeks Ended April 1, 2006**	Restatements	13 Weeks Ended April 1, 2006: restated
<b>Statement of operations:</b>					
Revenues	\$	\$ 6,035	\$ 6,035	\$	\$ 6,035
Operating and occupancy costs		3,338	3,338		3,338
Selling, general and administrative expenses	2,503	1,439	3,942	1,394	5,336
Depreciation and amortization	107		107		107
Total operating costs and expenses	2,610	4,777	7,387	1,394	8,781
Loss from operations	(2,610)	1,258	(1,352)	(1,394)	(2,746)
Amortization of discount on debt	(530)		(530)		(530)
Loss on early extinguishment of debt	(5,039)		(5,039)		(5,039)
Other expense, net	(964)		(964)		(964)
Loss from continuing operations before income tax	(9,143)	1,258	(7,885)	(1,394)	(9,279)
Income tax	35		35		35
Net loss from continuing operations	(9,178)	1,258	(7,920)	(1,394)	(9,314)
Discontinued operations	20,860	(1,258)	19,602	1,394	20,996
Net income attributable to common shareholders	\$ 11,682		\$ 11,682		\$ 11,682
Basic and diluted net loss per common share from continuing operations	\$ (0.87)	\$ 0.12	\$ (0.75)	\$ (0.13)	\$ (0.88)
Basic net income per common share from discontinued operations	\$ 1.98	\$ (0.12)	\$ 1.86	\$ 0.13	\$ 1.99
Diluted net income per common share from discontinued operations	\$ 1.98	\$ (0.12)	\$ 1.86	\$ 0.13	\$ 1.99

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Basic net income per common share	\$	1.11	\$		\$	1.11	\$		\$	1.11
Diluted net income per common share	\$	1.11	\$		\$	1.11	\$		\$	1.11

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\* per the quarterly report on Form 10-Q for the period ended April 1, 2006

\*\* per the quarterly report on Form 10-Q for the period ended July 1, 2006

### **Note 12. Subsequent Event**

On April 12, 2007, BSML, Inc. (the Company ), received a written Staff Determination Notice (the Notice ) from the NASDAQ Stock Market ( NASDAQ ) stating that the Company is not in compliance with NASDAQ s Marketplace Rule

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4310(c)(2)(B) because the Company's stockholders' equity was \$2,482,000, the market value of the Company's listed securities was \$15,256,879, and because the Company had reported net losses from continuing operations in its annual filings for the years ended December 30, 2006, December 31, 2005, and December 25, 2004. NASDAQ Rule 4310(c)(2)(B) requires a company to have a minimum of \$2,500,000 in stockholders' equity or \$35,000,000 market value of listed securities or \$500,000 of net income from continuous operations for the most recently completed fiscal year or two of the three most recently completed fiscal years.

The Company determined that it would not be able to successfully cure its deficiencies in regard to NASDAQ Marketplace Rule 4310(c)(2)(B). As a result, the Company's common shares have been delisted from the NASDAQ Stock Market.



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

#### **Overview**

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 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.

As of December 31, 2005, the Company had an agreement with Dental Spas, Inc. to sell its Centers business, but this agreement was terminated on May 1, 2006. Since the agreement with Dental Spas to sell the Centers business was terminated 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 continuing operations in the financial statements consist of sales, costs of sales and operating expenses of our Centers business, including our corporate expenses. In March 2006, we completed the sale of our Associated Centers business. The financial data of the Associated Centers has been prepared in accordance with Statement of Financial Accounting Standards No. 144,

Accounting for the Impairment or Disposal of Long-Lived Assets. Accordingly, the results of operations for the Associated Centers for all periods presented have been reflected as discontinued operations. There are no assets or liabilities of the Associated Centers business as of April 1, 2006 or subsequently.

#### **Critical Accounting Policies And Estimates**

##### ***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.

##### ***Revenue Recognition***

The Company recognizes revenue related to retail products at the time such products are shipped to customers and procedure revenues at the time the procedure is performed. Revenue is reported net of discounts and allowances. In the third quarter of 2004, the Company introduced its SmileForever program. Under this program, Center customers may, for an additional fee, receive a limited number of touch-up procedures over a specified term, typically one to two-years. The revenue associated with this program is deferred and recognized over the contractual term.

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Additionally, in cases where SmileForever revenue is bundled with procedure revenue and / or revenue from retail product sales, revenue is allocated to SmileForever using the fair values of the components of the

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bundle per the requirements of EITF 00-21 and any revenue so allocated is then deferred and recognized over the contractual term. At March 31, 2007 and December 30, 2006, the deferred revenue balances associated with the SmileForever program were \$4.0 million and \$3.9 million, respectively.

### *Inventories*

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

### *Sales Tax Liability*

Through the date of this report, certain states have issued initial 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 circumstances and the advice of its independent counsel and advisors, management has estimated and accrued approximately \$1.2 million through March 31, 2007 for potential additional sales tax liability related to these assessments and related state sales tax matters.

The Company may further increase its tax reserve in 2007 in response to tax assessments received to date. The Company intends to vigorously challenge the imposition of these tax assessments, and believes it has substantial grounds for its position. Nonetheless, the Company may attempt to negotiate a resolution of such 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 some or all of these tax assessments discussions 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 the assessments, and will re-evaluate the adequacy of its reserves as new information or circumstances warrant.

**Table of Contents*****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 period ended March 31, 2007 compared to the 13-weeks period ended April 1, 2006:**

**Total Revenues, Net** grew 19%, to \$7.2 million in our first quarter of 2007 compared to \$6.0 million in the first quarter of 2006. Whitening revenues grew 3%, to \$4.7 million in the first quarter of 2007 compared to \$4.5 million in the first quarter of 2006. This increase reflects an increase in whitening procedures performed of more than 40%, offset by reduced revenue procedure resulting from price reductions implemented during 2006. The balance of the revenue increase was due to higher SmileForever revenue, which grew to \$0.8 million in 2007 compared to \$0.4 million in 2006, higher QVC revenue, which grew to \$0.8 million in 2007 compared to \$0.5 million in 2006, and higher retail product sales, which grew to \$0.8 million in 2007 from \$0.5 million in 2006.

**Operating and occupancy costs** grew 9%, to \$3.6 million in the first quarter of 2007 from \$3.3 million in the first quarter of 2006, reflecting additional cost of goods sold relating to our higher retail and QVC network sales, while our spa occupancy costs were nearly identical in the two periods.

**Selling, General and Administrative expenses** decreased to \$3.7 million in the first quarter of 2007 from \$5.3 million in the first quarter of 2006. This decrease was primarily due to our downsizing activities subsequent to the sale of the Associated Centers business in March 2006, with salary expense falling to \$0.8 million in the first quarter of 2007 from \$1.7 million in the first quarter of 2006. Salary expense in the first quarter of 2006 included approximately \$0.7 million in severance expense not associated with discontinued operations. Professional fees, primarily legal expense, were also lower, totaling \$0.3 million in the first quarter of 2007 compared to \$0.6 million in the first quarter of 2006.

**Depreciation and Amortization expense** increased to \$362,000 in the first quarter of 2007 compared to \$107,000 in the first quarter of 2006. Depreciation expense in the 2006 period was halted on fixed assets subject to the proposed sale of the Centers business. When plans to sell the Centers business were cancelled in the second quarter of 2006, year-to-date depreciation expense on the affected assets was then recognized.

**Loss on early extinguishment of debt and amortization of discount on convertible debt.** All of the Company's debt was repaid by the proceeds of the sale of the Associated Centers business in March 2006. A loss on extinguishment of debt of \$5.0 million was recognized during the thirteen-week period ended April 1, 2006. Also, the Company issued convertible debt in December 2004 that was valued net of discount and that discount was being amortized over the life of the debt using the effective interest method until the March 2006 repayment date. For the 13-week period ended April 1, 2006, the Company recorded \$530,000 of amortization.

**Other Income and expense, net.** For the thirteen-week period ended March 31, 2007 other income, net of expenses, was \$141,000 and was composed primarily of interest earned. As all of the Company's debt was repaid in March 2006, we did not have any interest expense in this period. For the comparable period in 2006, we had net expense of \$964,000 primarily related to fees associated with the terminated plans to sell the Centers business.

**Table of Contents****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 Associated Centers business in March 2006. At March 31, 2007, the Company had \$3.5 million in unrestricted cash. 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. However, the Company has yet to achieve profitability from operations. Therefore, the Company may be required to raise additional funds through new debt or equity issuance. There can be no assurance that such funds will be available at an acceptable cost, or at all, and if that proves to be the case, the Company's operations may be negatively impacted.

Proceeds received from the sale of the Associated Centers business on March 13, 2006 were used to pay off long-term debt, capital leases and accrued interest, (\$19.4 million); to establish an escrow account from which payments can be made for indemnity claims which may arise in connection with the sale of the Associated Centers business and intellectual property to Discus (\$3.6 million in escrow as of March 31, 2007), to pay costs associated with the asset sale transaction (\$1.3 million), to pay legal expenses 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 tax and other taxes related to the Discus transaction (\$0.6 million). Any remaining proceeds have been 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 operating profitability on a sustained basis. The Company does have, as of March 31, 2007, approximately \$6.3 million in restricted funds included in Investments, restricted as to use. This amount includes a \$1.5 million writ of attachment in connection with the Smile Inc. Asia Pte. Ltd. litigation (see Item 3, Legal Proceedings, above), the \$3.6 million escrow established to indemnify Discus from claims arising from the March 2006 sale of the Associated Centers business and \$1.2 million in other restricted deposits. The Discus escrow is scheduled to be released in June 2007, but the Company is aware of potential claims that may reduce the amount of funds to be released and / or delay the release. 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 position of the Company 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. The primary future 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 March 31, 2007:

	Total	Payments Due by Period (in thousands)			
		Remaining 2007 (Nine Months)	2008-2009	2010-2011	2012 and Thereafter
<b>Contractual obligations:</b>					
Operating leases	\$ 10,433	\$ 2,831	\$ 6,450	\$ 695	\$ 457
Consulting and office equipment service contracts	382	156	202	19	5
<b>Total</b>	<b>\$ 10,815</b>	<b>\$ 2,987</b>	<b>\$ 6,652</b>	<b>\$ 714</b>	<b>\$ 462</b>

**Sources of Cash, Liquidity and Capital Resources**

In the thirteen weeks ended March 31, 2007, net cash used in operations was \$1.3 million, primarily reflecting \$1.0 million of payments of income taxes due and previously accrued professional and marketing expenses. An additional \$0.3 million of cash use was related to our seasonal reduction of deferred revenues associated with gift certificates sold in the fourth quarter of 2006.

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Essentially no cash was used or provided by investing or financing activities in the thirteen weeks ended March 31, 2007.

### **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 30, 2006.

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**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.

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, the sale of the Company's Associated Centers business operations was followed by significant reductions in staff. Also, the Company's Chief Executive Officer and the Company's Chief Financial Officer were hired in November 2006 and February 2007, respectively, and therefore have limited experience with the company's internal controls over financial reporting. Further, we remain heavily dependent on legacy information technology systems that lack adequate documentation and require substantial manual supplementary efforts in support of some of our revenue recognition processes. As a result of these factors, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are not effective as of the period covered by this report.

The Company intends to make improvements to its policies, procedures, systems and staff who have significant roles in disclosure controls and in internal controls over financial reporting in order to address any remaining deficiencies and to demonstrate that its disclosure controls and controls over financial reporting are effective.

There were no significant changes in our internal controls during our last fiscal quarter, other than those referenced above that have materially affected our 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.

A summary of legal matters settled or dismissed prior to March 31, 2007 is provided in the Company's annual report on Form 10-K for the year ended December 30, 2006.

The following cases or claims remain active and pending against the Company:

*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.

During multi-day hearings held on October, November and December of 2006, the court heard arguments and granted in part the Company's motion for summary judgment dismissing Smile's claims for conversion, unjust enrichment, civil conspiracy, interference with contractual and economic relations and constructive trust as a claim. In addition, the court ruled that Smile is not entitled to recover the approximately \$2.4 million in prejudgment interest that it was seeking to recover.

On February 28, 2007, the court held the first day of an evidentiary hearing regarding the reliability of Smile's expert witness testimony on lost profits damages.

The Company is subject to a prejudgment writ of attachment in the amount of \$1.5 million based on a stipulation of the parties. No trial date is currently set.

*Claims of Oraceutical LLC, Oraceutical Innovative Properties LLC, and R. Eric Montgomery*. In April 2007, Oraceutical LLC, Oraceutical Innovative Properties LLC, and R. Eric Montgomery (collectively, Oraceutical) filed suit in California state court naming as defendants the Company and its subsidiary BriteSmile Development, Inc. (BDI), the Company's Chief Executive Officer, Dr. Julian C. Feneley (Feneley), and the Company's Chairman of the Board, Mr. Anthony M. Pilaro (Pilaro). The complaint also names as defendants Discus Dental, Inc. and its subsidiary BriteSmile Professional, Inc. (collectively, Discus), neither of whom is affiliated with the Company. The complaint seeks to recover at least \$11.3 million plus punitive and exemplary damages. The complaint asserts claims against the Company and BDI for breach of contract, breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty, unjust enrichment, fraud, violations of California Business & Professions Code § 17200 et seq., and accounting, and asserts a fraud claim against Feneley and Pilaro. The complaint also includes a declaratory judgment claim against the Company, BDI, and Discus.



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The claims in the complaint are based on an Asset Purchase Agreement, as subsequently amended (the "APA"), entered into

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between Oraceutical, the Company and BDI in July 2003. Pursuant to the APA, 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.

In March 2006, the intellectual property acquired from Oraceutical was sold to Discus along with other assets of the Company in a transaction valued at \$35 million, with \$8.7 million allocated to settle patent infringement litigation with Discus. In the complaint Oraceutical claims that value of the patent infringement settlement should be substantially more than \$8.7 million. If the value was \$8.7 million, and after considering appropriate off-sets and deductions required by the APA, Oraceutical would not be entitled to any part of the consideration received from Discus. The declaratory judgment claim seeks a declaration that Discus should be bound by the terms of the APA as the party who acquired the subject intellectual property from BDI.

A response to the complaint is not yet due. The Company intends to respond to the complaint on or before the due date and will vigorously contest all claims. Among other defenses, the Company will present substantial evidence concerning the \$26.8 million value of the assets acquired by Discus and the \$8.7 million value of the Discus patent litigation settlement, including opinions of the Company's investment banker in the Discus transaction, Piper Jaffray.

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**

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 Centers business to Discus, the Company agreed to indemnify Discus for a number of matters, including the breach of our representations, warranties and covenants contained in the Asset Purchase Agreement with Discus, as well as any potential additional local sales, stamp, or value added tax obligations. 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. A material 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 Centers.

We are aware of one such potential dispute. Discus, the purchaser of our Associated Center business in March of 2006, has notified the Company of a pending dispute over collection of receivables from Longlife Health Ltd. (Longlife), the Company's former distributor in the United Kingdom. A portion of the receivables in question were a component of the assets sold to Discus. Subsequent to the sale of the Associated Centers business, Discus terminated Longlife's distribution agreement. Longlife alleges that the termination of the distribution agreement was wrongful and, in response, has withheld payment of the receivables. Discus has notified the Company that it will seek relief for its losses which are subject to the Company's indemnity obligations under the Asset Purchase Agreement between Discus and the Company as a result of this dispute. To the Company's knowledge, no litigation has been filed by Longlife or Discus. After consulting with the Company's legal counsel concerning this matter, management believes that likely damages will be immaterial to the Company's results. Therefore, no provision for potential loss has been made in our results of operations for the year ended December 30, 2006 or for the fiscal quarter ended March 31, 2007. However, it remains possible that unfavorable resolution of any or all of the Longlife or Discus claims that may ultimately arise from this dispute could materially affect our results of operations in 2007 or subsequent years.

**We have been delisted from the Nasdaq SmallCap Market, which has resulted in a limited public market for our common stock, and may adversely affect the price and trading volume of our common stock.**

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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.

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At various times in the past, we were not in compliance with one or more of the foregoing requirements, and we received notices from Nasdaq to that effect. Since our shareholders' equity at December 30, 2006 was less than \$2.5 million, we did not meet this requirement for continued listing on Nasdaq, resulting in our delisting. Further, we cannot guaranty that we will be in compliance with applicable continued listing requirements in the future.

Trading of our stock continues on the pink sheets, but this is more difficult than trading on an exchange and our stock price could decrease. Also, since our stock is not currently listed on an exchange, it is possible that many potential investors will not purchase it, which would further limit the trading market for our common stock.

### **The Company's certifying officers are not able to represent that the Company's internal controls over financial reporting are functioning adequately to prevent material misrepresentation of the Company's results of operations.**

Extensive effort has been made to insure that the Company's results of operations and financial position are fairly presented in accordance with accounting principles generally accepted in the United States of America. However, the sale of the Associated Centers business in the first quarter of 2006 was followed by significant reductions in staff. Also, the Company's Chief Executive Officer and Chief Financial Officer have relatively short tenure in their respective positions and therefore have only limited experience with the Company's internal controls over financial reporting. Further, we remain heavily dependent on legacy information technology systems that lack adequate documentation and require substantial manual supplementary efforts in support of some of our revenue recognition processes. These factors, singly and in combination, result in risk that the Company's financial results could be materially misstated.

### **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 quarterly variations in operating results and 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 the thirteen weeks ended March 31, 2007, we had a net loss of \$0.4 million. For 2006, we had net income of \$4.4 million, including \$19.3 million in income from discontinued operations primarily as a result of the sale of the Associated Centers business to Discus and associated settlement of patent litigation with Discus. In 2005 and 2004, we had net losses of \$17.8 million and \$7.8 million, respectively. As of March 31, 2007, our accumulated deficit was \$171.8 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 we cannot guarantee that our business will be profitable on a sustained basis.

## **Lease Renewal**

All of our Centers operate their facilities under operating leases that expire at various dates through July 2015. As these leases expire, we may not be able to renew them at acceptable rates or at all. We are currently operating one Center on a month-to-month rental basis because that Center's lease has expired. Higher lease rates will negatively affect our results of operations. If, in any case, we are required to relocate to a different facility, we will be subject to additional costs for new leasehold improvements and we may incur higher lease costs and /or loss of business, negatively impacting our results of operations.

## **Inflation**

Most of our products are purchased in finished form and packaged by the supplier or at our headquarters. 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.

**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.

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### **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 teeth-whitening solutions offered to consumers. We also market BriteSmile-branded toothpaste, mouthwash, the BriteSmile-to-Go pen, and post-whitening procedure touchups through our Centers, the QVC television network 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.

### **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 consumer spending which, in turn, drives our services and products is affected by general economic conditions. In 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 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. 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.

### **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. 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 30, 2006, we had net operating loss carryforwards of approximately \$149.5 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 (i) the issuance of certain convertible preferred stock, options, warrants, or other securities exercisable for common stock, (ii) changes in our equity ownership occurring in the last three years and (iii) 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 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

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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 potential future revenue and profitability.

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

### **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 LATW system was first used commercially, we have relied upon manufacturing and supply agreements with multiple suppliers, but only one manufacturer of our LATW devices. Effective April 2001, the Company's LATW devices are manufactured by Delphi Medical Systems Corporation, Longmont, Colorado, pursuant to an agreement between the Company and Delphi.

Additionally, Oraceutical is currently sole supplier of our retail products, including toothpaste, mouthwash and our teeth-whitening kit. Oraceutical is currently engaged in litigation with the Company (see Item 1, Legal Proceedings). Oraceutical has not disrupted our supplies or notified us of any intent to do so, but such a disruption would be difficult and time-consuming to resolve and our results of operations could suffer.

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.

### **We operate our Centers using intellectual property under a license granted to us by Discus Dental, and we cannot guarantee that competitors will not infringe the underlying patents or that certain patents that we have applied for will be granted.**

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

We sold Discus an expansive portfolio of patents to protect the intellectual property rights licensed to us, including a patent covering a method of whitening teeth by exposing teeth treated with a transparent composition to light and a patent covering the light source. There can be no assurance that Discus will prosecute patent applications that are valuable to our business or pursue infringement claims against third parties who may infringe the intellectual property rights we sold to Discus. Failure by Discus to protect these intellectual property rights may have an adverse effect on our business.

### **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.





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**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. In the event of such a suit, and further assuming a resolution to such a suit that is unfavorable to us, we may have to pay substantial damages for past infringement if it is ultimately determined that our products or services infringe a third party's proprietary rights. 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 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 the FDA's 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 FDA regulations will not change significantly or adversely in the future, or that we will not become subject to compliance with additional and stricter FDA 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 reduced 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 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.

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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 arising as a result of use of our products or services, 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, there can be no 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.**

#### **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 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).

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- 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).
- 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).

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### **Exhibits**

- 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 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 BSML 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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### **Exhibits**

- 10.22 Credit and Security Agreement dated December 13, 2001 between BSML 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).
- 10.23 Supplemental Agreement dated March 2002 to Credit and Security Agreement dated December 13, 2001 between BSML 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 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).
- 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).





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### **Exhibits**

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*	Letter Agreement between BSML and Nhat Ngo dated October 13, 2005. (Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005).
10.43*	Letter Agreement between BSML and Robert Sieban, Jr. dated October 13, 2005. (Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005).
10.44*	Letter Agreement between BSML and Ken Czaja dated November 18, 2005. (Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005).
10.45*	Letter Agreement between BSML and Julian Feneley dated November 21, 2005. (Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005).
10.46*	Letter Agreement between BSML and Christopher Edwards dated January 19, 2006. (Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005).
10.47	Asset Purchase Agreement among BSML, BSML International Limited, BSML 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).
10.48	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).
10.49	Contribution Agreement between BSML and BSML 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).
10.50*	Letter Agreement between BSML and Ken Czaja dated May 4, 2006 (Incorporated by reference to the Company's current report on Form 10-Q filed on August 21, 2006).
10.51*	Employment agreement, dated December 6, 2006, between Dr. Julian Feneley and the Company (previously filed as an exhibit to the Company's Current Report on Form 8-K, filed with the Commission on December 12, 2006, and incorporated herein by reference.)
10.52*	Employment agreement, dated December 29, 2006, between Richard De Young and the Company (previously filed as an exhibit to the Company's Amended Annual Report on Form 10-K/A and incorporated herein by reference).
14	Code of Ethics (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 27, 2003).
21.1	Subsidiaries of the Company. (Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005).
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 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.**

**/s/ Dr. Julian Feneley**  
**Dr. Julian Feneley**  
**Chief Executive Officer**  
**(Principal Executive Officer)**

**May 21, 2007**  
**Date**

**/s/ Richard De Young**  
**Richard De Young**  
**Vice President and Chief Financial Officer**  
**(Principal Financial and Accounting Officer)**

**May 21, 2007**  
**Date**