BRITESMILE INC
Form 10-Q
August 12, 2002

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

FORM 10-Q

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

For the Quarterly Period Ended: June 29, 2002

or

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

For the Transition Period from ___________ to ____________.

Commission File Number: 1-11064

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

UTAH	87-0410364
(State or other jurisdiction of incorporation or organization)	(IRS employer identification no.)

490 North Wiget Lane Walnut Creek, California	94598
(Address of principal executive offices)	(Zip Code)

(925) 941-6260
(Issuer's telephone number, including area code)

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

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

X yes no

The Company had 36,426,961 shares of common stock outstanding at July 16, 2002.

BRITESMILE, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Condensed Consolidated Balance Sheets as of June 29, 2002 and December 29, 2001.....3

Condensed Consolidated Statements of Operations for the 13 and 26 weeks ended June 29, 2002 and June 30, 2001.....5

Condensed Consolidated Statements of Cash Flows for the 26 weeks ended June 29, 2002 and June 30, 2001, respectively.....6

Notes to Condensed Consolidated Financial Statements.....7

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.....11

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.....19

Item 2. Changes in Securities.....19

Item 5. Other Information.....19

Item 6. Exhibits and Reports on Form 8-K.....19

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	June 29, 2002
CURRENT ASSETS:	
Cash and cash equivalents	$ 1,778
Cash, restricted as to use	843
Trade accounts receivable, net of allowance for doubtful accounts of $330 and $615, respectively	2,412
Inventories	2,397
Prepaid expenses and other	598
Notes receivable-current portion	223
Total current assets	8,251
PROPERTY AND EQUIPMENT, net.	21,143
OTHER ASSETS	1,779
TOTAL ASSETS..	$ 31,173

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

3

BRITESMILE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (continued)

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

	June 2 2002
CURRENT LIABILITIES:	
Accounts payable	$ 4
Accrued expenses	2
Deferred revenue	1
Note payable to related party, net of discount	
Accrual for store closures	
Line of credit.	
Capital lease obligation with related party -current portion.	

Total current liabilities	11
Note payable to related party, less current portion	1
Subordinated convertible debenture, net of discount.	
Capital lease obligations with related party, less current portion.	2
Accrual for store closures.	
Other long-term liabilities	
Total long-term liabilities	5
Total liabilities	16
SHAREHOLDERS' EQUITY:	
Common stock, $.001 par value; 50,000,000 shares authorized; 36,426,961 and 36,226,961 shares issued and outstanding, respectively	
Additional paid-in capital	137
Accumulated deficit	(123
Total shareholders' equity	14
Total liabilities and shareholders' equity	$ 3

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

4

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

	13 Weeks Ended June 29, 2002	13 Weeks Ended June 30, 2001 (as Restated)	26 W End June 20
REVENUES:			
Center whitening fees, net	$ 3,553	$ 3,904	$
Associated Center whitening fees, net	6,265	6,458	
Product sales	1,195	1,208	

Total revenues, net	11,013	11,570	
OPERATING COSTS AND EXPENSES:			
Operating and occupancy costs	3,924	4,383	
Selling, general and administrative expense	8,266	11,156	
Research and development expenses	181	19	
Depreciation and amortization	1,507	1,166	
Total operating costs and expenses	13,878	16,724	
Loss from operations	(2,865)	(5,154)	
OTHER INCOME (EXPENSE), net:			
Interest expense	(112)	(417)	
Interest income	9	102	
Total other income (expense), net	(103)	(315)	
Loss before income tax provision	(2,968)	(5,469)	
INCOME TAX PROVISION	18	4	
Net loss	$ (2,986)	$ (5,473)	$
BASIC AND DILUTED NET LOSS PER SHARE	$ (0.08)	$ (0.16)	$
WEIGHTED AVERAGE SHARES - BASIC AND DILUTED	$ 36,418,648	$ 33,301,498	$ 3

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

5

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

	26 Weeks E June 29, 2
CASH FLOWS FROM OPERATING ACTIVITIES:	

Net loss	$ (
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	
Store closure accrual	
Cost for issuance of stock warrants and stock options	
Changes in assets and liabilities	
Net cash used in operating activities	(
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchase of property and equipment	(
Net cash used in investing activities	(
CASH FLOWS FROM FINANCING ACTIVITIES:	
Net proceeds from line of credit	
Proceeds from debt financing.	
Proceeds from common stock offering.	
Principal payments on long-term debt	
Payments on capital lease obligations.	
Proceeds from exercise of stock options.	
Net cash provided by financing activities	
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD	
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD	$
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:	
Cash paid for interest	$
Cash paid for income taxes	$
Equipment acquired under capital lease	$

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

BRITESMILE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
June 29, 2002

1. Description of Business and Nature of Operations

BriteSmile, Inc., a Utah corporation ("BriteSmile" or the "Company"), and its affiliates develop and sell advanced teeth whitening products, services and technology. Unless specified to the contrary herein, references to BriteSmile or to the Company refer to the Company and its subsidiaries on a consolidated basis. The Company's operations include the development of technologically advanced teeth whitening processes that are distributed in professional salon settings known as BriteSmile Professional Teeth Whitening Centers ("Centers"). The Company also offers its products and technologies through arrangements with existing independent dental offices known as BriteSmile Professional Teeth Whitening Associated Centers ("Associated Centers"). As of June 29, 2002, the Company had 14 Centers and there were 4,404 Associated Centers in operation.

Centers are located in major metropolitan areas nationwide and offer clients a salon-like environment dedicated solely to the business of teeth whitening. Centers are staffed by licensed dentists and trained dental assistants. Alternatively, consumers can visit an Associated Center, where a local dentist administers the BriteSmile procedure in the dentist's established office. To date, the Company has entered into contracts with 4,404 Associated Centers, including 3,389 in the United States, and 1,015 in 40 countries outside the United States. The Company is not engaged in the practice of dentistry. Each licensed dentist who operates a Center or Associated Center maintains full control over dental matters, including the supervision of dental auxiliaries and the administration of the teeth whitening procedure.

The Company developed its current teeth whitening technology (the "BriteSmile Light Activated Teeth Whitening System," "BS2000," or "LATW") and began distribution in 1999. In November 1999 the Company introduced its new BriteSmile 3000 LATW keycard system (the "BS3000") to Associated Centers. The BS3000, a mobile version of the BS2000, can be installed quickly and provides improved flexibility and mobility in dental offices. In May 2001, the Company introduced its more versatile mobile device, the BS3000PB, which is the device currently shipped to Associated Centers. The BS2000, BS3000, and BS3000PB teeth whitening devices utilize a light technology. The unique delivery arm that permits blue green light to reach all 16 front teeth simultaneously, whitening the teeth by activating BriteSmile's wavelength-specific gel during three consecutive twenty-minute sessions.

Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information," established standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief decision maker, or chief decision making group, in deciding how to allocate resources and in assessing performance. Our CEO is our chief decision maker. Our business is focused on one industry segment, products and procedures to whiten teeth. All of our revenues and profits are generated through the sale, licensing, and service of products for this one segment.

2. Basis of Presentation and Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions in Form 10-Q and Article 10 of Regulations S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the 13 and 26 weeks ended June 29, 2002 are not necessarily

indicative of the results that may be expected for the remainder of the fiscal year ending December 28, 2002.

BRITESMILE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
June 29, 2002

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the 52 weeks ended December 29, 2001.

The accompanying consolidated financial statements include the accounts of the Company, its subsidiaries, and entities (Centers) in which the Company has a controlling interest. The Company consolidates the operating results of the Centers as the Company has a controlling financial interest in the Centers in accordance with the criteria of EITF 97-2, "Application of FASB Statement No. 94 and APB Opinion #16 to Physician Practice Management Entities ("PPM") and Certain Other Entities with Contractual Management Arrangements." The agreements with the Centers are 30 year, non-terminable agreements, that provide the Company a financial interest in the PPM and exclusive authority over all decision making other than the dispensing of medical services.

Revenue Recognition

The Company recognizes revenue related to retail products at the time such products are shipped to customers.

The Company recognizes revenue from teeth whitening procedures performed at its Centers when the procedures have been performed.

During the last quarter of the transition period ended December 30, 2000 and retroactive to April 1, 2000, the Company has changed its method of accounting to recognize revenue from Associated Centers, and does so ratably over the estimated period in which the Associated Centers perform the procedures, commencing when the key card is shipped or the access code provided. Previously, the Company recognized revenues from Associated Centers when the keycard or access code to activate the whitening device was shipped. Revenue is reported net of discounts and allowances. As of June 29, 2002, the Company recorded deferred revenue totaling $1.8 million, which will be recognized as revenue in the third quarter of 2002. At December 29, 2001, the deferred revenue balance was $763,000 and was recognized in the first quarter ended March 30, 2002. At March 30, 2002, the deferred revenue balance was $1,300,000 and was recognized in the quarter ended June 29, 2002.

3. Loss Per Common Share

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

effect is anti-dilutive.

4. Inventories

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

5. Reclassifications

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

6. Revisions to Previously Issued Financial Statements

The Company provides the use of whitening equipment (the teeth whitening system) and sells key card and supplies (procedure kits and retail products) to Associated Centers to enable the Associated Center to perform the whitening procedures for its customers. Prior to December 29, 2001, the Company recognized revenue related to the sale of the procedure kits upon shipment of the key cards and whitening supplies. Following discussion with the staff of the Securities and Exchange Commission regarding application of Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," the Company revised its revenue recognition policy related to these agreements to defer revenues, and to amortize these revenues into operations over the estimated period in which the procedures are performed by the Associated Centers, which is generally 30 days. As a result of this change in accounting policy, the Company has restated its quarterly financials for 2001. The following is the restatement for the comparative quarter ended June 30, 2001:

Consolidated Statement of Operations Data:	As previously reported
Total Associated Centers revenue.............................	$ 6,932
Total revenues..	$ 12,337
Net loss..	$ 4,374
Net loss per share, basic and diluted.........................	$ (0.13)

7. Financing Arrangements

Following is a summary of the Company's long and short term debt financing arrangements (in thousands):

	June 29, 2002	December 29, 2001
Note Payable to EVL, a related party,		
due May 10, 2006	$ 1,855	$ 2,083
5% Subordinated Convertible Notes due and payable on June 29, 2005 (including discount		

of $61 and $71)	739	729
Line of credit	729	-
	$ 3,323	$ 2,812

8. Store Closure Reserve

During the 39 weeks ended December 30, 2000, the Company's Board of Directors and management decided to close three of its less productive wholly-owned Centers. These Centers were located in Pasadena, California; Ft. Lauderdale, Florida, and Coral Gables, Florida. During the 52 weeks ended December 29, 2001, the Company's Board of Directors and management decided not to continue the construction of a Center in San Francisco, California. The Company recorded a store closure accrual to reserve for an estimated $934,000 related to the remaining lease obligation. As a result of the closures, at December 29, 2001, the Company had a store closure reserve accrual of $1.3 million related to lease termination costs including the present value of future lease payments, net of estimated sublease income. We recorded charges of $219,000 and $112,000 during the quarter ended March 30, 2002 and the current quarter respectively, which primarily related to the difference between our current rent obligations and the rate at which we expect to be able to sublease the properties. As of July 2002, all four of the spaces have been subleased.

The following table sets forth the store closure reserve activity during the twenty-six weeks ended June 29, 2002, (in thousands):

Balance at December 29, 2001	$1,210
Payments/Deductions	($331)
Balance at June 29, 2002	$879

9. Impact of Recently Issued Accounting Standards and Accounting Bulletins

In July 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 eliminates the pooling of interests method of accounting for business combinations, except for qualifying business combinations that were initiated prior to July 1, 2001. Under SFAS No. 142, goodwill and indefinite lived intangible assets are no longer amortized but are reviewed annually, or more frequently if impairment indicators arise, for impairment. The Company adopted SFAS Nos. 141 and 142 on December 30, 2001. The adoption of SFAS Nos. 141 and 142 did not have a material impact on its consolidated financial statements.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of the fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. SFAS No. 143 is effective for the Company for fiscal 2003. The Company believes that the adoption of SFAS No. 143 will not have a material impact on its consolidated financial statements.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or

Disposal of Long-Lived Assets," which supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and provides a single accounting model for long-lived assets to be disposed of. The Company adopted SFAS No. 144 on December 30, 2001. The adoption of SFAS No. 144 did not have a material impact on the Company's consolidated financial statements.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Diposal Activities," which addresses accounting for restructuring and similar costs. SFAS 146 supersedes previous accounting guidance, principally Emerging Issues Task Force Issue No. 94-3. The Company will adopt the provisions of SFAS 146 for restructuring activities after December 31, 2002. SFAS 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue 94-3, a liability for an exit cost was recognized at the date of the Company's commitment to an exit plan. SFAS 146 also establishes that the liability should initially be measured and recorded at fair value. Accordingly, SFAS 146 may affect the timing of recognizing future restructuring costs as well as the amounts recognized.

10. Subsequent Event

On July 19, 2002, the Company amended its Credit and Security Agreement with CAP Advisers which provided for a $2.5 million line of credit facility to a subsidiary of the Company. The maximum line of credit available was increased to $5.0 million. Advances under the line of credit may be used for general business purposes, including the purchase of whitening devices.

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

Forward-looking Statements and Risk Factors

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

forward-looking statements. Among others, risks and uncertainties that may affect the business, financial condition, performance, development, and results of operations of the Company include:

- Government regulation of the Company's products and teeth whitening procedures, including: (i) current restrictions or controls on the practice of dentistry by general business corporations, and (ii) future, unknown enactments or interpretations of current regulations which could, in the future, affect the Company's operational structure and relationships with licensed dentists.
- Failure of the Company to generate, sustain or manage growth, including failure to develop new products and expand Center and Associated Center locations and revenues;
- The loss of product market share to competitors and/or development of new or superior technologies by competitors;
- Ongoing operating losses associated with the development, marketing and implementation of new, light-activated teeth whitening technologies;
- Failure of the Company to secure additional financing to complete its plan for the rollout of a broad base of Associated Centers;
- Unproven market for the Company's new whitening products, whitening process, and "Whitening Center" and "Associated Center" concepts, in light of competition from traditional take-home whitening products and bleaching tray methods;
- Failure to develop marketing strategies and delivery methods to penetrate non-U.S. markets; and
- Lack of product diversity.

Critical Accounting Policies And Estimates

General

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial

statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to customer programs and incentives, bad debts, inventories, income taxes, warranty obligations, financing operations, restructuring, and contingencies and litigation. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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

Revenue Recognition

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

BriteSmile recognizes revenue at Centers at the time a whitening procedure is performed.

BriteSmile records deferred revenue at the time of sale of key cards and access codes to Associated Centers. Deferred revenue is recorded for the full value of the key cards and access codes at the time of sale only if BriteSmile is contractually entitled to invoice the Associated Center for the full value of the sale and the Associated Center is obligated to pay such invoice, thereby creating a corresponding account receivable. Deferred revenue is subsequently recognized as revenue over the estimated period that the whitening procedures, which can be performed via the key cards and access codes are expected to be used, currently 30 days from the date of shipment. A material change to the estimated time period over which the key cards and access codes are used could have a significant impact on BriteSmile's revenue in the period of change as well as future periods.

BriteSmile's policy is not to accept any return of key cards or access codes during the course of the agreement with an Associated Center; however, it does provide credits to the ultimate whitening customer for a "whitening guarantee." BriteSmile recognizes those credits by reducing its revenue.

Bad Debt

BriteSmile maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. A considerable amount of judgment is required in assessing the ultimate realization of accounts receivable including the current credit-worthiness of each customer. If the financial condition of BriteSmile's customers (dentists who operate Associated Centers) were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventory

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

Property, Equipment and Improvements - Carrying Value Near Recoverability Estimate

BriteSmile evaluates its property, equipment and improvements for impairment whenever indicators of impairment exist. Management determined that impairment indicators did exist in Fiscal 2001 based upon continued operating losses and negative cash flow. BriteSmile's current estimates of recoverability for its property, equipment and improvements indicated those assets would not have been recoverable if management's estimates of future cash flows had been 295% lower than its current estimate. BriteSmile's recoverability estimates are based on current revenue levels continuing to grow at approximately 20% per annum compared to an historical growth rate of approximately 114%. BriteSmile has

further assumed that operating costs will increase by approximately 3% per annum compared to an historical increase of approximately 157%. The Company completed a major restructuring of its cost structure in the fourth quarter of Fiscal 2001 with plans to reduce operating costs by approximately $14 million per year compared to Fiscal 2001. Had BriteSmile's recoverability estimates resulted in a

determination that these assets were not recoverable, BriteSmile would have recognized an impairment loss in Fiscal 2001. The Company does not believe impairment losses will need to be recognized in 2002, although no guarantee of such can be given.

Store Closures

During Fiscal 2001 (fiscal year ended December 29, 2001) and the Transition Period (nine-month transition period ended December 30, 2000), BriteSmile recorded significant reserves in connection with store closures. These reserves included estimates pertaining to the settlements of contractual obligations, primarily property leases. Although the Company does not anticipate significant changes, the actual costs related to the closures may differ from these estimates.

Legal Contingencies

BriteSmile is currently a party to certain legal actions. Management does not believe that current pending litigation will have a material adverse effect on BriteSmile's consolidated financial position. This conclusion has been developed in consultation with outside counsel handling BriteSmile's defenses in the matters. It is possible, however, that future results of operations for any particular quarterly or annual period could be materially affected by changes in management's assumptions and the effectiveness of BriteSmile's strategies related to these legal actions.

BriteSmile recognizes the costs of legal services in the periods incurred.

Overview

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

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

The following discussion should be read in conjunction with the Financial Statements and the Notes thereto included in Item 1 of this Quarterly Report on Form 10-Q and in the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2001.

[THE REMAINDER OF THIS PAGE INTENTIONALLY LEFT BLANK]

The following table sets forth unaudited operating results for the thirteen week periods and twenty-six week periods ended June 29, 2002 and June 30, 2001, as a percentage of sales in each of these periods. This data has been derived from the unaudited financial statements.

	Thirteen Weeks ended June 29, 2002	Thirteen Weeks ended (as Restated) (Note 6) June 30, 2001	Twenty-Six Weeks ended June 29, 2002	Twenty- Weeks en (as Rest (Note June 3 2001
Income Statement Data:				
Revenues:				
Center whitening fees, net	32.3%	33.7%	32.5%	
Associated Center whitening fees, net	56.9%	55.8%	56.4%	
Product sales	10.8%	10.5%	11.1%	
Total revenues, net	100.0%	100.0%	100.0%	1
Operating Costs and Expenses:				
Operating and occupancy costs	35.6%	37.9%	37.1%	
Selling, general and administrative expenses	75.1%	96.4%	79.3%	1
Research and development expenses	1.6%	0.2%	1.4%	
Depreciation and amortization	13.7%	10.1%	14.7%	
Total operating costs and expenses	126.0%	144.6%	132.5%	1
Loss from operations	-26.0%	-44.6%	-32.5%	-
Interest income (expense), net	-0.9%	-2.7%	-2.3%	
Loss before income tax provision	-26.9%	-47.3%	-34.8%	-
Provision for income taxes	0.2%	0.0%	0.2%	
Net Loss	-27.1%	-47.3%	-35.0%	-

The following are explanations of significant period-to-period changes for the 13 weeks ended June 29, 2002 and June 30, 2001:

Revenues

Total Revenues. Total revenues decreased by $557,000, or 4.8%, to $11.0 million for the 13 weeks ended June 29, 2002, from $11.6 million for the 13 weeks ended June 30, 2001. The decrease in revenues occurred in the Company Centers and

domestic Associated Centers primarily as a result of selling fewer whitening procedures in the higher yield centers. International whitening procedures and revenues increased in the 13 weeks ended June 29, 2002 compared to the same quarter of 2001. Sales in the second quarter of 2001 relating to newly placed Associated Centers were $2.8 million compared to $0.4 million in the second quarter of 2002.

As of June 29, 2002, the Company recorded deferred revenue totaling $1.8 million compared to $2.3 million of deferred revenue as of June 30, 2001. The deferred revenue balance at June 29, 2002 will be recognized in the third quarter 2002 in accordance with the Company's policy of recognizing revenue over the period in

which the whitening procedures are performed after shipment of key cards or access codes to Associated Centers. The deferred revenue balance of $1.8 million at the end of the second quarter increased $400,000 compared to the deferred revenue of $1.4 million at March 30, 2002 as a result of higher Associated Center whitening fees in June 2002 compared to March 2002

Center Whitening Fees. Center whitening fees decreased by $351,000, or 9.0%, to $3.6 million for the 13 weeks ended June 29, 2002, from $3.9 million for the 13 weeks ended June 30, 2001. The number of procedures performed in the Centers decreased to 8,067 in the second quarter of 2002, compared to 8,735 in the same quarter of 2001.

Associated Center Whitening Fees. Associated Center whitening fees decreased by $193,000, or 3.0%, to $6.3 million for the 13 weeks ended June 29, 2002, from $6.5 million for the 13 weeks ended June 30, 2001. This decrease was due to the sale of fewer procedures in the 13 weeks ended June 29, 2002 compared to the 13 weeks ended June 30, 2001. The number of procedures sold in the Associated Centers increased 19.5% to 36,295 procedures in the second quarter of 2002 compared to 30,360 procedures in the same quarter of 2001. Domestic Associated Center whitening procedures were 27,970 in the 13 weeks ended June 29, 2002 compared to 28,905 in the same quarter of 2001. International Associated Center whitening procedures were 8,325 in the 13 weeks ended June 29, 2002 compared to 1,455 in the same quarter of 2001. Sales in the second quarter of 2001 relating to newly placed Associated Centers were $2.8 million compared to $0.4 million in the second quarter of 2002.

The Company continues to execute its strategic plan of expanding distribution into the professional dental practice channel through its Associated Centers. The Company also anticipates adding additional Associated Centers in domestic and international locations over the next twelve months, resulting in increased Associated Center whitening fees. There can be no guarantee that the Company will be successful in executing its business plan.

Product Sales. Product sales slightly decreased by $13,000 or 1.1% to $1.19 million for the 13 weeks ended June 29, 2002, from $1.2 million for the 13 weeks ended June 30, 2001. Product sales represent the Company's toothpaste, mouthwash, whitening gum, and the Sonicare toothbrush products sold at Centers and Associated Centers. There can be no assurance that the Company will be successful selling more retail products in the future.

Operating Costs and Expenses

Operating and Occupancy Costs. Operating and occupancy costs was $3.9 million or 35.6% as a percentage of revenues for the thirteen weeks ended June 29, 2002, compared to $4.4 million or 37.9% as a percentage of revenues in the thirteen weeks ended June 30, 2001. This decrease was primarily due to a 1.82% decrease

in cost of goods sold as a percentage of sales due to the reduction of various individual component unit costs.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased significantly to $8.3 million or 75.1% as a percentage of revenue for the second quarter of 2002 compared to $11.2 million or 96.4% as a percentage of revenue in the corresponding period in 2001. The $2.9 million decrease was in line with the expense restructuring instituted in late fiscal 2001 as discussed in further detail in the Liquidity and Capital Resources section. The Company expects that savings as a result of the new infrastructure will continue to be achieved throughout fiscal 2002, although no guarantee of such can be given.

Research and Development Expenses. Research and development expenses of $181,000 was 1.6% as a percentage of revenue for the thirteen weeks ended June 29, 2002 compared to $19,000 or 0.2% as a percentage of revenue in the corresponding period in 2001. The expense incurred in the first quarter of 2002 was primarily related to research studies to expand the Company's leadership position in the teeth-whitening industry.

Depreciation and Amortization. Depreciation and amortization increased to $1.5 million or 13.7% as a percentage of revenue for the second quarter of 2002 compared to $1.2 million or 10.1% as a percentage of revenue in the corresponding period in 2001. The increase of $341,000 in depreciation and amortization expense to $1.5 million for the second quarter of 2002 is the result of a greater number of BS3000 and BS3000PB devices in operation as a result of the increase in the number of active Associated Centers.

Interest Expense, net. Interest expense, net decreased to $103,000 or 0.9% as a percentage of revenue for the second quarter of 2002 compared to interest expense, net of $315,000 or 2.7% as a percentage of revenue in the corresponding quarter of 2001. The higher interest expense in the second quarter of 2001 primarily was due to the acceleration of interest expense for the December 2000

Note in the amount of $253,000, along with other debt incurred by the Company and the amortization of the fair market value of the warrants issued with that debt.

Net Loss. The net loss decreased $2.5 million to $3.0 million for the second quarter of 2002 compared to a net loss of $5.5 million in the corresponding quarter of 2001. This represents a 45.4% improvement due to a combination of the factors described above. The net loss per share for the second quarter of 2002 was ($0.08) versus ($0.16) reported for the second quarter of 2001.

The following are explanations of significant period-to-period changes for the 26 weeks ended June 29, 2002 and June 30, 2001:

Revenues

Total Revenues. Total revenues decreased by $140,000, or 0.7%, to $20.4 million for the 26 weeks ended June 29, 2002, from $20.5 million for the 26 weeks ended June 30, 2001. As of June 29, 2002, the Company recorded deferred revenue totaling $1.8 million compared to $2.3 million of deferred revenue as of June 30, 2001.

Center Whitening Fees. Center whitening fees decreased by $1.3 million, or 16.3%, to $6.6 million for the 26 weeks ended June 29, 2002, from $7.9 million for the 26 weeks ended June 30, 2001. $265,000 of this decrease was primarily

due to the closure of three underperforming Centers that were open for a portion of the first quarter of 2001 and the remainder of the decrease was in the existing 14 Centers. The number of procedures performed in the Centers decreased to 14,917 for the 26 weeks ended June 29, 2002, compared to 17,889 for the same period of 2001.

Associated Center Whitening Fees. Associated Center whitening fees increased by $982,000, or 9.4%, to $11.5 million for the 26 weeks ended June 29, 2002, from $10.5 million for the 26 weeks ended June 30, 2001. This increase was due to the operation of 4,404 Associated Centers at the end of the 26 weeks ended June 29, 2002 compared to 2,206 Associated Centers that were in operation at the end of the 26 weeks ended June 30, 2001. The number of procedures sold in the Associated Centers increased 31.8% to 68,320 procedures in the 26 weeks ended June 29, 2002 compared to 51,820 procedures in the same period of 2001. Domestic Associated Center whitening procedures were 54,665 in the 26 weeks ended June 29, 2002 compared to 49,560 in the same period of 2001. International Associated Center whitening procedures were 13,655 in the 26 weeks ended June 29, 2002 compared to 2,260 in the same period of 2001.

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

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

Product Sales. Product sales increased by $169,000 to $2.3 million for the 26 weeks ended June 29, 2002, from $2.1 million for the 26 weeks ended June 30, 2001. Product sales represent the Company's toothpaste, mouthwash, whitening gum, and the Sonicare toothbrush products sold at Centers and Associated Centers. However, there can be no assurance that the Company will be successful in selling more retail products in the future.

Operating Costs and Expenses

Operating and Occupancy Costs. Operating and occupancy costs was $7.54 million or 37.1% as a percentage of revenues for the twenty-six weeks ended June 29, 2002, compared to $7.58 million or 37.0% as a percentage of revenue in the twenty-six weeks ended June 30, 2001. The consistent cost percentage is due to the consistency of the operating costs which includes costs of goods sold and lease financing costs for both the Centers and Associated Centers and the operating and occupancy costs for the Centers.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased significantly to $16.1 million or 79.3% as a percentage of sales for the twenty-six weeks ended June 29, 2002 compared to

16

$21.0 million or 102.4% as a percentage of revenue in the corresponding period in 2001. The $4.9 million decrease was in line with the expense restructuring instituted in late fiscal 2001 as discussed in further detail in the Liquidity and Capital Resources section. The Company expects that savings as a result of

the new infrastructure will continue to be achieved throughout fiscal 2002, although no guarantee of such can be given.

Research and Development Expenses. Research and development expenses of $292,000 was 1.4% as a percentage of sales for the twenty-six weeks ended June 29, 2002 compared to $567,000 or 2.8% as a percentage of revenue in the corresponding period in 2001. This reduction in expenses is primarily due to the fact the Company continues to incur costs for research studies to expand its leadership position in the teeth-whitening industry, but the number of studies has decreased versus the same period in 2001.

Depreciation and Amortization. Depreciation and amortization increased to $3.0 million or 14.7% as a percentage of revenue for the twenty-six weeks ended June 29, 2002 compared to $2.4 million or 11.6% as a percentage of revenue in the corresponding period in 2001. The increase of $611,000 in depreciation and amortization expense to $3.0 million for the twenty-six weeks ended June 29, 2002 is the result of a greater number of BS3000 and BS3000PB devices in operation as a result of the increase in the number of active Associated Centers.

Interest Expense,net. Interest expense, net decreased to $470,000 or 2.3% as a percentage of revenue for the twenty-six weeks ended June 29, 2002 compared to interest expense, net of $530,000 or 2.6% as a percentage of revenue in the corresponding period of 2001.

Net Loss. The net loss decreased $4.5 million to $7.1 million for the twenty-six weeks ended June 29,2002 compared to a net loss of $11.6 million in the corresponding period of 2001. This represents a 38.7% improvement due to a combination of the factors described above. The net loss per share for the twenty-six weeks ended June 29, 2002 was ($0.20) versus ($0.37) reported for the same period of 2001.

Liquidity and Capital Resources

The Company's principal sources of liquidity have been issuances of convertible debt, common stock and common stock equivalents. At June 29, 2002, the Company had $1.8 million of cash and cash equivalents. The Company expects to sign contracts for additional Associated Centers during the next twelve months. This expansion is contingent upon several factors, including available cash resources and acceptance by consumers and Associated Center dentists of the Company's LATW products. The Company expects that its principal uses of cash will be to provide working capital, to finance capital expenditures, and to satisfy other general corporate expenses. In particular, the Company plans to use its cash to finance its marketing strategy.

During the first quarter of 2002, the Company obtained a $2.5 million line of credit from CAP Advisers, and $4 million in shortfall guarantees. See "CAP Advisers Line of Credit," and "Additional Working Capital Guarantees" below. In July 2002, this line of credit from CAP Advisers was amended and increased to $5.0 million The Company also amended its EVL Lease Agreement to defer payment of monthly rental on LATW devices to year 2003. See "EVL Lease Line Amendment" below.

Post September 11 Expense Reductions. During the weeks following the September 11, 2001 terrorist attacks, the Company saw an immediate drop in revenue. The New York area Associated Centers, and the Company's own Center in New York, were affected most severely. The Company assessed the operating variables that could be controlled and immediately responded to the decline in sales. Management has and is implementing several cost saving initiatives totaling approximately $14 million over Fiscal 2002. Through the first six months of Fiscal 2002, the Company has hit its cost targets and expects to do the same throughout Fiscal 2002 to achieve the $14 million cost reduction goal. The Company expects to

achieve these cost savings in the areas of Center operations, procedure kit production, various selling, general and administrative costs including legal and consulting fees, and leveraging its marketing spending more effectively by utilizing smaller media specific agencies, thereby reducing agency fees. As a result, management expects selling, general and administrative expenses to be leveraged more efficiently as sales from Centers and Associated Centers increase in the future. Depending upon the operating results, the Company may increase its advertising spending.

CAP Advisers Line of Credit. In December 2001, as amended in March 2002, BriteSmile International, a wholly-owned subsidiary of the Company, entered into Credit and Security Agreements with CAP Advisers which provide for a $2.5

million line of credit facility to a subsidiary of the Company. In July 2002 this line of credit was increased to $5.0 million.

EVL Lease Amendment. The Company pays EVL a monthly rental for each LATW device leased, consisting of a fixed amount, plus a "variable rent" payment in the amount of $125 for each key card or access code sold to an Associated Center where EVL is the lessor of the LATW device. Of the 4,404 LATW devices in operation at Associated Centers at June 29, 2002, 3,000 of such devices were leased to the Company by EVL. Each key card or access code enables Associated Center dentists to perform 5 teeth whitening procedures (i.e. variable rent of $25 per procedure).

On March 8, 2002, the Company and EVL amended their lease agreement to provide that the variable rent portion of the monthly rental payments during 2002, in the amount of $25 for each BriteSmile procedure, will be deferred and paid to EVL in twelve equal monthly installments beginning January 9, 2003, with interest payable on the deferred amount at a rate equal to LIBOR, as quoted by The Bank of Nova Scotia for the applicable adjustment dates for deposits in U.S. Dollars for one month maturities, plus 200 basis points. As of June 29, 2002, the deferred amount for the second quarter of 2002 was $599,500; $1,192,125 has been deferred for the twenty-six weeks ended June 29, 2002. The deferred amount is included in the accrued expenses balance as of June 29, 2002.

Additional Working Capital Guarantees. In March 2002 the Company received Commitment Letters from certain guarantors (the "Guarantors") to severally purchase, on or before December 31, 2002, up to $4 million of additional shares of common stock of the Company (or to otherwise secure, collateralize, or make available such funds to the Company). The aggregate purchase amount committed by the Guarantors equals the difference between $4 million, and the "Excess Cash Receipts" to be realized by the Company in 2002. "Excess Cash Receipts," for this purpose, is defined to mean cash received by the Company through sales of the Company's debt or equity securities, additional borrowings, or cash receipts in excess of projections at December 29, 2001. In consideration for the Guarantors' Commitment Letters, the Company issued to the Guarantors five-year warrants to purchase an aggregate of 80,000 shares of common stock of the Company at an exercise price of $5.00 per share.

There can be no assurance that additional capital will not be required, or that it will be available on terms that are acceptable to the Company. Additionally, there can be no assurance that the Company's business will generate cash flows at or above current levels. Accordingly, the Company may choose to defer capital expenditure plans or further reduce operating expenditures.

Cash flow used in operations improved by $7.9 million to negative $(4.3) million for the twenty-six weeks ended 2002 from negative $(12.2) million used in

operating activities during the same period of 2001, primarily due to the decrease in the net loss recognized and the net effect of timing differences in the collection and disbursement of working capital components. Between the two periods, there has been a significant improvement in the average number of days receivables outstanding.

Net cash provided by financing activities was $744,000 for the twenty-six weeks ended June 29, 2002, compared to $29.7 million for the same period in 2001. The $744,000 net cash consisted of: 1) $504,000 of proceeds from the exercise of stock options, 2) $728,000 cash from net proceeds from the Company's international line of credit to fund the rollout of devices, and 3) $229,000 principal payment on long-term debt and 4) $259,000 payments on capital lease obligations.

The $29.7 million of net cash provided by financing activities for the twenty-six weeks ended June 30, 2001 primarily was due to the private placement of the Company's common stock in the net amount of $26.6 million completed in April 2001.

Capital expenditures were $1.8 million for the twenty-six weeks ended June 29, 2002, compared to $3.3 million for the same period in 2001. Starting in June 2001, the Company commenced a rapid expansion of new Associated Centers which continued through August 2001. The capital expenditures for both periods were primarily related to the purchase of BS3000PB systems for deployment at new domestic and international Associated Centers.

Inflation

Most of the Company's products are purchased in finished form and packaged by the supplier or at the Company's headquarters. The Company anticipates usual inflationary increases in the price of its products and does not intend to pass

these increases along to its customers, primarily as a result of other operating efficiencies gained through changing the sourcing of certain of its products. In general, the Company does not believe that inflation has had a material effect on its results of operations in recent years. However, there can be no assurance that the Company's business will not be affected by inflation in the future.

Seasonality

Although the Company does not believe that its business follows seasonal trends, it has recognized that at various times during the months of July and August and again during December and January, a substantial number of Associated Centers (both domestic and international) shut down for vacation. As a result, the frequency of key card purchases by Associated Centers during these months declines as well. Additionally, the Company's Centers have recognized some seasonality during the same months because of customer vacations.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On April 23, 2002, Smile Inc. Asia Pte. Ltd. ("Smile") sued the Company and

BriteSmile Management, Inc., a wholly owned subsidiary of the Company, in the Third Judicial District Court in Salt Lake City, Utah. The Complaint alleges that BriteSmile Management breached its 1998 distributor agreement with Smile by failing to fill orders placed and to perform other obligations under the agreement. The Complaint also alleges that BriteSmile Management and the Company fraudulently induced Smile to enter into the distributor agreement, and includes claims for damages based on alleged unjust enrichment, civil conspiracy, breach of the duty of good faith and fair dealing, interference with contractual and economic relations, and fraudulent transfer. The Company believes that the claims asserted by Smile are entirely without merit and will vigorously defend the lawsuit. The Company has commenced discovery with regard to Smile's claims.

The Company filed a complaint against Discus Dental, Inc. in the United States District Court for the Northern District of California on July 8, 2002. The complaint, civil action number C02-3220JF, alleges infringement of the Company's United States Patents No. 6,343,933, issued February 5, 2002, and No. 6,361,320, issued March 26, 2002. The complaint alleges that Discus Dental, Inc.'s sale of infringing products sold to dental professionals under the Zoom! trademark infringes both patents under 35 USC ss. 271, seeks injunctive relief, damages under 35 USC ss. 284, and costs and attorneys' fees. As of August 1, 2002, Discus Dental, Inc. had not filed an answer to the complaint.

On May 31, 2002, the Company filed a complaint against Discus Dental, Inc. in Contra Costa County Superior Court, California, case no. C02-01611, alleging causes of action for Intentional Interference with Contractual Relationship, Negligent Interference with Contractual Relationship, Violation of Unfair Business Practice Act - Loss Leader, Violation of Unfair Business Practice Act, Trade Libel and Injunctive Relief. The complaint alleges that Discus Dental and other defendants yet to be identified wrongfully interfered with the Company's contractual relationships with its Associated Center dentists, in part by writing letters with the purpose of inducing the Company's Associated Dentists to terminate their contracts with BriteSmile and switch to Discus' Zoom! system, and by making false and disparaging statements concerning BriteSmile's system. The Complaint seeks damages for loss of business, punitive damages, injunctive relief, and costs of suit. On June 27, 2002, Discus filed a demurrer to BriteSmile's complaint, challenging the legal sufficiency of the complaint. On June 30, 2002, the court ruled that BriteSmile will be able to pursue its claims as alleged in the complaint except for the second cause of action alleging Negligent Interference with Contractual Relationship.

ITEM 2. CHANGES IN SECURITIES

During the period December 30, 2001 to June 29, 2002, the Company granted to key employees under its 1997 Stock Option and Incentive Plan non-qualified options to purchase an aggregate of 1,724,684 shares of the Company's common stock, at exercise prices ranging from $3.30 to $9.69 per share. The options vest over a period of time following their respective dates of grant. The Company claimed exemption from registration under the Securities Act of 1933 for these grants in that the Company believes such grants were not "sales" within the meaning of the Act. Shares issuable upon exercise of the options have been or will be registered with the SEC pursuant to Registration Statements on Form S-8.

ITEM 4. CHANGE IN REGISTRANTS' CERTIFYING ACCOUNTANT

On June 26, 2002, the Company filed with the Securities and Exchange Commission a Current Report on Form 8-K to report a change in the Company's certifying accountant.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(A) EXHIBITS

10(a) Supplemental Agreement dated July 19, 2002 to Credit and Security Agreement dated December 13, 2001 and to Unsecured Credit Agreement dated March 8, 2002 (filed herewith).

10(b) Employment agreement effective June 17, 2002 between the Company and Bruce Fleming (filed herewith).

20

99(a) Certification of Peter P. Hausback, CFO, pursuant to Section 906 Of The Sarbanes-Oxley Act Of 2002 (filed herewith).

99(b) Certification of John L. Reed, CEO, pursuant to Section 906 Of The Sarbanes-Oxley Act Of 2002 (filed herewith).

(B) REPORTS ON FORM 8-K

On June 26, 2002, the Company filed with the Securities and Exchange Commission a Current Report on Form 8-K to report a change in the Company's certifying accountant..

[THE REMAINDER OF THIS PAGE INTENTIONALLY LEFT BLANK]

21

SIGNATURES

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

BRITESMILE, INC.

/s/ John L. Reed — August 9, 2002
John L. Reed — Date
Chief Executive Officer

/s/ Peter P. Hausback — August 9, 2002
Peter P. Hausback — Date
Chief Financial Officer