ENDOCARE INC
Form 424B3
August 07, 2007

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Prospectus Supplement No. 3 to Prospectus dated March 30, 2007
Filed Pursuant to Rule 424(b)(3)
Registration Statement No. 333-123866

Endocare, Inc.
Supplement No. 3
to
Prospectus Dated March 30, 2007

This is a Supplement to Endocare, Inc. s Prospectus, dated March 30, 2007, with respect to the offer and sale of up to 9,580,126 shares of our common stock by the selling securityholders listed herein or their transferees. This Supplement amends and supplements certain information contained in the Prospectus. You should read this Supplement carefully.

Endocare is a specialty medical device company focused on improving patients lives through the development, manufacturing and distribution of health care products for cryoablation. The term cryoablation or cryosurgery refers to the use of ice to destroy tissue, such as tumors, for therapeutic purposes. Today, our FDA-cleared Cryocare Surgical System occupies a growing position in the urological market for treatment of prostate and renal cancer. We believe our proprietary cryosurgical technologies also have broad applications across a number of other surgical markets, including for the treatment of tumors in the lung and liver and palliative intervention (treatment of pain associated with metastases).

Our common stock is traded on the Over-the-Counter Bulletin Board, or OTCBB, under the symbol ENDO. On July 31, 2007, the last reported sale price of our common stock on the OTCBB was $2.48 per share.

YOU SHOULD CAREFULLY CONSIDER THE RISK FACTORS FOR OUR SHARES, WHICH ARE LISTED IN THE PROSPECTUS.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the securities to be issued under this Supplement and the Prospectus or determined if this Supplement or the Prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus supplement is August 6, 2007

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QUARTERLY REPORT ON FORM 10-Q

On August 6, 2007, we filed our Quarterly Report on Form 10-Q for the quarter ended June 30, 2007, a copy of which is included below.

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007

OR

o **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: 001-15063

Endocare, Inc.
(Exact name of Registrant as Specified in Its Charter)

DELAWARE	**33-0618093**
(State of Incorporation)	*(I.R.S. Employer I.D. No.)*

201 TECHNOLOGY DRIVE, IRVINE, CALIFORNIA 92618
(Address of Principal Executive Office, Including Zip Code)
(949) 450-5400
(Registrant s Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definitions of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer o Accelerated Filer þ Non-Accelerated Filer o

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

The number of shares of the Registrant s common stock, par value $.001 per share, outstanding at June 30, 2007 was 34,784,939.

Endocare, Inc.
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Part II. Other Information

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PART I FINANCIAL INFORMATION

Item 1. ***Condensed Consolidated Financial Statements***

ENDOCARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(Unaudited)			
	(In thousands, except per share data)			
Total revenues	$ 7,901	$ 6,908	$ 15,447	$ 14,170
Costs and expenses:				
Cost of revenues	2,713	3,256	5,335	7,021
Research and development	621	475	1,236	1,486
Selling and marketing	4,099	3,904	7,862	7,673
General and administrative	2,845	2,072	6,674	6,067
Total costs and expenses	10,278	9,707	21,107	22,247
Loss from operations	(2,377)	(2,799)	(5,660)	(8,077)
Interest expense related to common stock warrants		1,908		1,696
Interest income, net	113	183	139	349
Loss from continuing operations before taxes	(2,264)	(708)	(5,521)	(6,032)
Tax benefit on continuing operations				151
Loss from continuing operations	(2,264)	(708)	(5,521)	(5,881)
Income from discontinued operations (including gain on disposal of $0.5 million in 2006), net of taxes				245
Net loss	$ (2,264)	$ (708)	$ (5,521)	$ (5,636)
Net (loss) income per share basic and diluted:				
Continuing operations	$ (0.07)	$ (0.02)	$ (0.17)	$ (0.20)
Discontinued operations	$	$	$	$ 0.01
Weighted average shares of common stock outstanding	32,748	30,166	31,854	30,155

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

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ENDOCARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2007	December 31, 2006
	(Unaudited) (In thousands, except per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 7,245	$ 1,811
Accounts receivable, net	5,079	4,161
Inventories, net	2,597	2,260
Prepaid expenses and other current assets	1,862	1,284
Total current assets	16,783	9,516
Property and equipment, net	786	1,040
Intangibles, net	3,328	3,613
Investments and other assets	982	2,077
Total assets	$ 21,879	$ 16,246
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 3,384	$ 3,393
Accrued compensation	2,911	3,000
Line of credit	1,123	
Other accrued liabilities	3,379	3,594
Total current liabilities	10,797	9,987
Other long term liabilities	194	74
Common stock warrants		1,307
Stockholders equity:		
Preferred stock, $0.001 par value; 1,000 shares authorized; none issued and outstanding		
Common stock, $0.001 par value; 50,000 shares authorized; 34,785 and 30,679 issued and outstanding as of June 30, 2007 and December 31, 2006, respectively	35	31
Additional paid-in capital	197,190	181,289
Accumulated deficit	(186,337)	(176,442)
Total stockholders equity	10,888	4,878
Total liabilities and stockholders equity	$ 21,879	$ 16,246

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

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ENDOCARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30,	
	2007	2006
	(Unaudited) (In thousands)	
Cash flows from operating activities:		
Net loss	$ (5,521)	$ (5,636)
Adjustments to reconcile net loss to net cash used in operating activities:		
Gain on divestiture		(418)
Depreciation and amortization	613	857
Loss on sale of placement units and other fixed assets	52	
Extinguishment of payroll tax liabilities	(121)	(869)
Stock-based compensation	1,576	1,858
Net interest expense related to common stock warrants		(1,696)
Changes in operating assets and liabilities:		
Accounts receivable	(918)	540
Inventories	(407)	305
Prepaid expenses and other assets	516	531
Accounts payable	(7)	(279)
Accrued compensation	79	(1,045)
Other liabilities	(95)	(1,561)
Net cash used in operating activities	(4,233)	(7,413)
Cash flows from investing activities:		
Purchases of property and equipment	(56)	(86)
Proceeds from divestitures		7,277
Net cash provided by (used in) investing activities	(56)	7,191
Cash flows from financing activities:		
Stock options exercised		108
Net borrowings on line of credit	1,123	
Proceeds from sale of common stock	8,600	
Net cash provided by financing activities	9,723	108
Net increase (decrease) in cash and cash equivalents	5,434	(114)
Cash and cash equivalents, beginning of period	1,811	8,108
Cash and cash equivalents, end of period	$ 7,245	$ 7,994

Non-cash activities:		
Transfer of inventory to property and equipment for placement at customer sites	$ 174	$ 361
Transfer of Cryocare Surgical Systems from property and equipment to inventory for sale	$ 105	$ 376
Note receivable received in divestiture	$	$ 1,425
Adoption of FSP 00-19-2:		
Reduction of retained earnings	$ 4,373	$
Increase in additional paid-in capital	$ 5,680	$
Reduction of common stock warrant liability	$ 1,307	$

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

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Endocare, Inc. and Subsidiary
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular numbers in thousands, except per share data)
(Unaudited)

1. Organization and Operations

We are a medical device company focused on developing, manufacturing and selling cryoablation products which have the potential to assist physicians in improving and extending life by use in the treatment of cancer and other tumors. We were formed in 1990 as a research and development division of Medstone International, Inc. (Medstone), a manufacturer of shockwave lithotripsy equipment for the treatment of kidney stones. Following our incorporation under the laws of the state of Delaware in 1994, we became an independent, publicly-owned corporation upon Medstone s distribution of our stock to the existing stockholders on January 1, 1996.

Through February 10, 2006, we also offered vacuum therapy systems for non-pharmaceutical treatment of erectile dysfunction through our wholly-owned subsidiary Timm Medical Technologies, Inc. (Timm Medical), which was sold to a third party effective February 10, 2006 (see Note 4 - *Sale of Timm Medical*). The operating results of Timm Medical through the date of sale are included in discontinued operations.

2. Basis of Presentation

Following the rules and regulations of the Securities and Exchange Commission (SEC), we have omitted footnote disclosures in this report that would substantially duplicate the disclosures contained in our annual audited financial statements. The accompanying condensed consolidated financial statements should be read together with the consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K, filed with the SEC on March 16, 2007.

The accompanying condensed consolidated financial statements reflect all adjustments, consisting solely of normal recurring accruals, needed to present fairly the financial results for these interim periods. The condensed consolidated results of operations presented for the interim periods are not necessarily indicative of the results for a full year. All intercompany transactions and accounts have been eliminated in consolidation.

3. Recent Operating Results and Liquidity

Since inception, we have incurred losses from operations and have reported negative cash flows. As of June 30, 2007, we had an accumulated deficit of $186.3 million and cash and cash equivalents of $7.2 million. Of the cash balance, $1.1 million is borrowed on our line of credit, which is payable on a current basis. As of June 30, 2007, we have sold $1.6 million in stock under our agreement with Fusion Capital Fund II, LLC (Fusion Capital) and $7.0 million in stock to Frazier Healthcare V, L.P. (Frazier) as more fully described below.

We do not expect to reach cash flow positive operations in 2007, and we expect to continue to generate losses from operations for the foreseeable future. These losses have resulted in part from our continued investment to gain acceptance of our technology and investment in initiatives that we believe should ultimately result in cost reductions. Although in July 2006 we resolved the investigations by the SEC and DOJ of our historical accounting and financial reporting (see Note 10 *Commitments and Contingencies*), we still have obligations to indemnify and advance the legal fees of our former officers and former directors in connection with the ongoing investigations and legal proceedings related to those individuals. The amount of those legal fees may exceed the reimbursement due to us from our directors and officers liability insurance, and the excess may have a material adverse effect on our business, financial condition, results of operations and liquidity. For the six months ended June 30, 2007, we incurred expenses of $1.0 million relating to legal fees of former officers and former directors and recorded insurance recoveries of $0.7 million. As of June 30, 2007, there remained an aggregate of $0.3 million in coverage. For a description of this insurance coverage, please refer to the Form 8-K that we filed on February 25, 2005 and Note 10 *Commitments and Contingencies.*

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We also face large cash expenditures in the future related to past due state and local tax obligations, primarily sales and use taxes, which we estimate to be approximately $2.5 million. The amount was fully accrued as of June 30, 2007. We are in the process of negotiating resolutions of the past due state and local tax obligations with the applicable tax authorities. However, there is no assurance that these obligations will be reduced as a result of the negotiations or that we will be allowed to pay the amounts due over an extended period of time.

We also intend to continue investing in our sales and marketing efforts to physicians in order to raise awareness and gain further acceptance of our technology. This investment is required in order to increase physicians usage of our technology in the treatment of prostate and renal cancers, lung and liver cancers and palliative intervention (treatment of pain associated with metastases). Such costs will be reported as current period charges under generally accepted accounting principles.

We received $7.0 million from the sale of our common stock to Frazier in May 2007. Our other funding sources include a $16.0 million common stock purchase agreement with Fusion Capital and a $4.0 million credit agreement with Silicon Valley Bank discussed below. The funding availability under both agreements is subject to many conditions, some of which are predicated on events that are not within our control. Under the Fusion Capital agreement, we are limited as to the amount of stock we can sell each time. It also contains default provisions and is automatically suspended if the trading prices of our shares fall below $1.00. In addition, the extent to which we rely on Fusion Capital as a source of funding will depend on a number of factors including the prevailing market price per share of our common stock. The bank credit facility contains restrictive covenants and subjective acceleration clauses that permit the lender to accelerate payment of all outstanding balances or cease to make further advances to us in the event of default or if the lender determines in its judgment that a material adverse change has occurred or will occur. Although we are in compliance with these conditions and covenants as of June 30, 2007, there is no assurance that we will be able to comply with all requirements in future periods, that we can obtain a waiver if an event of default occurs or that the lender will not exercise the subjective acceleration clause. Accordingly, we cannot guarantee that these capital resources will be available when needed or will be sufficient.

As of June 30, 2007, we had sold 880,191 shares of stock to Fusion Capital for total gross proceeds of $1.6 million. Since we have authorized 8,000,000 shares for sale under the stock purchase agreement, the selling price of our common stock to Fusion Capital would have to average at least $2.00 per share for us to receive the maximum proceeds of $16.0 million. As of June 30, 2007, we had $1.1 million outstanding under the line of credit facility, which expires on February 27, 2008. The terms of these agreements are described in Note 5 *Private Placement of Common Stock and Warrants,* and Note 6 *Bank Line of Credit.*

Our continuing losses, cash flow deficits, and our obligations, along with the contingencies in our funding sources, together raise substantial doubt about our ability to continue as a going concern. The accompanying financial statements have been prepared assuming that we will continue as a going concern and do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

We expect to use existing cash reserves, working capital through the sale of our products, as well as future proceeds from sales, if any, of common stock to Fusion Capital and borrowings under our credit facility, to finance our projected operating and cash flow needs, along with continued expense management efforts. We have reduced operating cash use over the past five years by streamlining our corporate structure, focusing resources on our core products and strategic initiatives, re-engineering our products to lower manufacturing costs, reducing use of consultants and professional services and delaying or eliminating non-essential spending. We have also instituted additional equity incentive programs to reduce cash compensation outlays.

We may borrow funds under our line of credit with our bank for short-term needs as long as we remain in compliance with the representations, warranties, covenants and borrowing conditions. We believe that the financing with Fusion Capital and our line of credit with our bank should provide us with the capital resources that we need to reach the point where our operations will generate positive cash flows. However, our cash needs are not entirely predictable. Even if we are able to access the full $16.0 million under the common stock purchase agreement with Fusion Capital, we may still need additional capital to fully implement our business, operating and development plans. In addition, if financing from Fusion Capital were to prove unavailable or prohibitively dilutive and if we are unable

to sell enough of our products, we would need to secure another source of funding in order to satisfy our

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working capital needs. Accordingly, we cannot guarantee the availability of these capital resources or that they will be sufficient to fund our ongoing operations to the point where our operations will generate positive cash flows.

Because of the subjective acceleration clauses and other contingencies referred to above, the audit report of our independent auditors contained in our Annual Report on Form 10-K filed on March 16, 2007 contains an unqualified opinion with an explanatory paragraph, to the effect that there is substantial doubt about our ability to continue as a going concern. This opinion could itself have a material adverse effect on our business, financial condition, results of operations and cash flows.

4. Sale of Timm Medical

On January 13, 2006, we entered into a stock purchase agreement with Plethora Solutions Holdings plc (Plethora), a company listed on the London Stock Exchange. Under this agreement Plethora agreed to acquire Timm Medical, a wholly owned subsidiary of Endocare, for $9.5 million. The transaction closed on February 10, 2006. After the sale, we did not receive significant direct cash flows from Timm Medical and had no significant continuing involvement in its operations. In accordance with Statement of Financial Accounting Standard (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* the assets and liabilities of Timm Medical were classified as discontinued operations in the condensed consolidated financial statements from the date we decided to sell Timm Medical. Sale proceeds (net of $0.6 million in transaction costs) totaled $8.9 million and resulted in a gain on sale of $0.5 million in the first quarter of 2006. Gross proceeds of $9.5 million include cash of $8.1 million and a two-year, five percent promissory note for $1.4 million which is secured by the assets of Timm Medical. The note is convertible into Plethora s ordinary shares at any time at our option. If Plethora s shares trade above a specified price for 20 consecutive days, Plethora has the option to require conversion. We are currently in discussions with Plethora to potentially accelerate the payment of the note for a lump sum discounted amount. Based on these discussions we have reserved $0.3 million of the note balance in the fourth quarter of 2006. Net cash proceeds from the divestiture were $7.3 million after $0.6 million in transaction costs and $40,000 in cash of Timm Medical as of the date of disposition.

We agreed to retain certain assets and liabilities of Timm Medical, including all tax liabilities totaling $1.1 million, obligations and rights to a $2.7 million note receivable from SRS Medical Corporation, relating to the sale of Timm Medical s urinary incontinence product line in 2003, certain litigation to which Timm Medical was a party and ownership of Urohealth BV (Timm Medical s wholly-owned subsidiary with insignificant operations). Assets and liabilities we retained and their related revenues and expenses are excluded from discontinued operations. The stock purchase agreement requires that payments under the promissory note described above be placed in an indemnification escrow in certain circumstances to indemnify Plethora against certain claims and liabilities.

Assets and liabilities sold to Plethora as of February 10, 2006 included the following:

Assets:	
Cash, inventories and other current assets	$ 1,041
Property and equipment, net	71
Goodwill, net	4,552
Intangibles, net	3,680
Other assets	65
Total assets	9,409
Liabilities:	
Accounts payable and other current liabilities	502
Other accrued liabilities	486
Total liabilities	988

Net assets	$ 8,421

Revenues for Timm Medical were $1.0 million (for the period from January 1, 2006 through date of sale, February 10, 2006). Income from discontinued operations for the six months ended June 30, 2006 included a $0.5 million gain on disposal and is net of $0.2 million in taxes.

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5. Private Placement of Common Stock and Warrants

May 2007 Private Placement

On May 24, 2007 we entered into a common stock subscription agreement with Frazier and on May 25, 2007 we entered into a registration rights agreement with Frazier. Under the subscription agreement, Frazier agreed to purchase 3,255,814 shares of our common stock at a price per share of $2.15, for aggregate proceeds to us of $7.0 million.

In the subscription agreement, Frazier agreed to lock-up provisions restricting the transferability of the shares, for a period of one year for 75 percent of the shares and a period of 18 months for 25 percent of the shares. The lock-up provisions expire early if we undergo a change in control or if we issue significant additional amounts of securities in certain circumstances after May 25, 2007, as described in the subscription agreement.

In the registration rights agreement, we agreed to file a registration statement with the SEC on or before February 25, 2008 to register the shares for resale. We also agreed to use commercially reasonable efforts to cause the registration statement to become effective as promptly as possible thereafter, with the intention that the registration statement will be available for resale by Frazier once the lock-up restrictions expire. In addition, we agreed to use commercially reasonable efforts to keep the registration statement effective until May 25, 2010.

Fusion Capital Equity Purchase Agreement

On October 25, 2006, we entered into a common stock purchase agreement with Fusion Capital as described above under Note 3 *Recent Operating Results and Liquidity*. Under this agreement we have the right to sell to Fusion Capital up to $16.0 million worth of common stock, at our election, over a two year period at prices determined based upon the market price of our common stock at the time of each sale, without any fixed discount. Common stock may be sold in $100,000 increments every fourth business day, with additional $150,000 increments available every third business day if the market price per share of our common stock is $1.50 or higher, subject to our ability to comply with certain ongoing requirements discussed below. This $150,000 increment can be further increased at graduated levels up to $1.0 million if the market price per share increases from $1.50 to $6.00. If the price of the stock is below $1.00 per share, the obligation for Fusion Capital to buy any shares of stock is automatically suspended. Under the terms of the agreement, we issued 473,957 shares of common stock to Fusion Capital for no consideration as a commitment fee.

Under a related registration rights agreement, before Fusion Capital was obligated to purchase shares, we were required to file a registration statement covering the sale of up to 8,473,957 common shares within 20 days of signing the agreement. The registration statement was filed in November 2006 and declared effective by the SEC on December 1, 2006. We subsequently filed a post-effective amendment to the registration statement, which was declared effective March 30, 2007. We are required to maintain effectiveness of the registration statement until the earlier of the date that Fusion Capital may sell the shares without restriction pursuant to Rule 144(k) or the date that Fusion Capital has sold all purchased shares and no available unpurchased shares remain under the agreement. Upon occurrence of certain events of default as defined in the stock purchase agreement, including lapse of effectiveness of the registration statement for 10 or more consecutive business days or for 30 or more business days within a 365-day period, suspension of trading for 3 business days, delisting of the shares from the principal market on which they are traded, failure by our stock transfer agent to issue shares within 5 business days, or other material breaches, Fusion Capital may terminate the stock purchase agreement. We have the right to terminate the agreement at any time.

Through June 30, 2007, we had sold 880,191 shares for gross proceeds of $1.6 million. We are obligated to pay a transaction fee equal to 6.0 percent of the stock proceeds to an investment advisory firm under a pre-existing capital advisory agreement. In relation to this agreement we have prepaid $100,000 in fees to the investment advisory firm in 2006. Through June 30, 2007 we incurred $99,000 of these fees. As of June 30, 2007, we have approximately $14.4 million in remaining funding available with Fusion based on our closing stock price on that date.

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March 2005 Private Placement

On March 11, 2005, we completed a private placement of 5,635,378 shares of our common stock and detachable warrants to purchase 3,944,748 common shares at an offering price of $2.77 per share, for aggregate gross proceeds of $15.6 million. Transaction costs were $1.0 million, resulting in net proceeds of $14.6 million. Of the total warrants, 1,972,374 had an initial exercise price of $3.50 (Series A warrants) per share and 1,972,374 had an initial exercise price of $4.00 (Series B warrants) per share. The expiration date of the warrants is May 1, 2010. One current member and one former member of our management team made personal investments totaling $0.7 million in the aggregate, and a member of our Board of Directors invested $0.3 million.

The warrants have an anti-dilution clause that is triggered upon issuance of a certain number of shares of our common stock that reduces the effective exercise price of the warrants to preserve the ownership of the warrant holders. As a result of our May 2007 private placement and the issuance of shares to Fusion Capital through June 30, 2007, the exercise price of the Series A Warrants decreased to $3.34 to effectively provide holders an additional 95,019 shares and the Series B Warrant exercise price decreased to $3.79 effectively providing the Series B Warrant holders an additional 111,592 shares.

The warrants initially are exercisable at any time during their term for cash only. The warrants may be exercised on a cashless exercise basis in limited circumstances after the first anniversary of the closing date if there is not an effective registration statement covering the resale of the shares underlying the warrants. Each warrant is callable by us at a price of $0.01 per share underlying such warrant if our stock trades above certain dollar per share thresholds ($6.50 for the Series A warrants and $7.50 for Series B warrants) for 20 consecutive days commencing on any date after the effectiveness of the registration statement, provided that (a) we provide 30-day advanced written notice (Notice Period), (b) we simultaneously call all warrants on the same terms and (c) all common shares issuable are registered. Holders may exercise their warrants during the Notice Period and warrants which remain unexercised will be redeemed at $0.01 per share.

Upon exercise, we will pay transaction fees equal to 6.0 percent of the warrant proceeds under a pre-existing capital advisory agreement.

Pursuant to the terms of the registration rights agreement relating to the March 2005 financing, we filed with the SEC a registration statement on Form S-2 under the Securities Act of 1933, as amended, covering the resale of all of the common stock purchased and the common stock originally underlying the issued warrants. The S-2 registration statement was declared effective September 28, 2005. We subsequently filed a post-effective amendment on Form S-3, which was declared effective March 28, 2006 and a post-effective amendment on Form S-1, which was declared effective March 30, 2007.

The registration rights agreement provides that if a registration statement is not filed within 30 days of closing or does not become effective within 90 days thereafter, then in addition to any other rights the holders may have, we will be required to pay each holder an amount in cash, as liquidated damages, equal to one percent of the aggregate purchase price paid by such holder per month. We incurred $0.6 million of liquidated damages through September 28, 2005, when the S-2 registration statement was declared effective.

Under the registration rights agreement, we could incur similar liquidated damages in the future (equal to one percent of the aggregate purchase price paid by each affected holder per month) if holders are unable to make sales under the registration statement (for example, if we fail to keep the registration statement current as required by SEC rules or if future amendments to the registration statement are not declared effective in a timely manner). The registration obligation remains outstanding until the earlier of the date on which all shares issuable upon exercise of the warrants have been issued and resold by the holders of the warrants or the date on which all such shares can be resold by the holders without registration.

Since the liquidated damages under the registration rights agreement could in some cases exceed a reasonable discount for delivering unregistered shares, we accounted for the registration payment arrangement and warrants as one instrument classified as a derivative (a non-current liability) under EITF No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock*. We allocated a portion of the March 2005 offering proceeds to the warrants based on their fair value at issuance. Through December 31, 2006, we revalued the warrants as a derivative instrument quarterly in connection with changes in the underlying stock price

and other assumptions, with the change in value recorded as interest expense. In December 2006, the Financial

Accounting Standards Board issued FASB Staff Position (FSP) No. 00-19-2, *Accounting for Registration Payment Arrangements*, which changed the way we account for the outstanding warrants. FSP No. 00-19-2 specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement should be separately recognized and measured in accordance with SFAS No. 5, *Accounting for Contingencies.* For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to the issuance of this FSP and that continue to be outstanding at the adoption date, this guidance is effective for fiscal years beginning after December 15, 2006 and interim periods within those fiscal years. Upon adoption of FSP No. 00-19-2 on January 1, 2007, the value of the warrants as of the original issue date ($5.7 million) was reclassified to equity without regard to the contingent obligation to transfer consideration under the registration payment arrangement. The difference between the $5.7 million and the carrying value of the warrant liability as of December 31, 2006 ($1.3 million) was recorded as a cumulative-effect adjustment to reduce opening retained earnings on January 1, 2007. Hereafter, accruals for liquidated damages, if any, will be recorded when they are probable and reasonably estimable.

6. Bank Line of Credit

As described above in Note 3 *Recent Operating Results and Liquidity*, on October 26, 2005, we entered into a one-year credit facility with Silicon Valley Bank (the lender), which provided up to $4.0 million in borrowings for working capital purposes in the form of a revolving line of credit and term loans (not to exceed $500,000). The agreement was amended in February, April and December 2006 and was extended to February 28, 2007. In February 2007 the agreement was further extended to February 27, 2008, as described below.

The credit facility permits the borrowings up to the lesser of $4.0 million or amounts available under a borrowing base formula based on eligible accounts receivable and inventory. As amended, the borrowing base is (i) 85 percent of eligible accounts receivable, plus (ii) the lesser of 30 percent of the value of eligible inventory or $500,000. Borrowings are secured by all of our assets, including all receivable collections which are held in trust for the Bank. Interest is payable monthly at prime rate plus 1.5 percent. The agreement requires a one-time commitment fee of $40,000 paid on the effective date and an annual facility fee equal to 0.5 percent of the unused portion of the facility. A termination fee will also be assessed if the credit facility is terminated prior to expiration. We had no outstanding borrowings at December 31, 2006. As of June 30, 2007 there was $1.1 million outstanding on the line of credit.

As a condition to each advance under the credit facility, all representations and warranties by us must be materially true and no event of default must have occurred or be continuing. In addition, the lender, in its good faith business judgment, must determine that no material adverse change has occurred. A material adverse change occurs when there is a material impairment in the priority of the lender s lien in the collateral or its value, a material adverse change in our business, operations or condition, a material impairment of the prospect of repayment or if the lender determines, in its good faith reasonable judgment, that there is a reasonable likelihood that we will fail to comply with one or more financial covenant in the next financial reporting period.

The agreement governing the credit facility contains various financial and operating covenants that impose limitations on our ability, among other things, to incur additional indebtedness, merge or consolidate, sell assets except in the ordinary course of business, make certain investments, enter into leases and pay dividends without the consent of the lender. The credit facility also includes a subjective acceleration clause and a requirement to maintain a lock box with the lender to which all collections are deposited. Under the subjective acceleration clause, the lender may declare default and terminate the credit facility if it determines that a material adverse charge has occurred. If the aggregate outstanding advances plus reserves placed by the lender against the loan availability exceeds 50 percent of the receivable borrowing base component as defined, or if a default occurs, all current and future lock box proceeds will be applied against the outstanding borrowings. The credit facility also contains cross-default provisions and a minimum tangible net worth requirement measured on a monthly basis. Tangible net worth must be equal to or greater than the sum of a base amount ($1,000 as of June 30, 2007) plus 25 percent of all consideration received from issuing equity securities and subordinated debt and 25 percent of positive consolidated net income in each quarter.

We were not in compliance with the minimum tangible net worth covenant for the months September 2006 to November 2006. On December 22, 2006, we signed an amendment to the agreement governing the credit facility. Among other things, the amendment (i) modified the borrowing base to increase the eligible accounts receivable

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from 80 percent to 85 percent and modified the definition of accounts that are ineligible under the borrowing base calculation; (ii) modified the loan margin as defined to 1.50 percent, and (iii) waived non-compliance with the minimum tangible net worth requirement at September 30, 2006, October 31, 2006 and November 30, 2006, and modified the terms of the covenant. As of December 31, 2006 and June 30, 2007, we were in compliance with all covenants. During February through May 2007, the outstanding advances exceeded 50 percent of the receivable borrowing base referred to above. As required by the agreement our lock-box proceeds were applied daily to reduce the outstanding advances and we re-borrowed the amount subject to the lender s approval through June 30, 2007. The daily borrowings and repayments have been presented on a net basis in the condensed consolidated statements of cash flows. As of July 13, 2007, we were no longer required to repay and re-borrow funds on a daily basis.

On February 23, 2007, the credit agreement was amended to further modify the minimum tangible net worth provision and to extend the maturity date to February 27, 2008.

7. Capital Stock and Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding for the respective periods. Diluted loss per share, calculated using the treasury stock method, gives effect to the potential dilution that could occur upon the exercise of certain stock options and warrants that were outstanding during the respective periods presented. For periods when we reported a net loss, these potentially dilutive common shares were excluded from the diluted loss per share calculation because they were anti-dilutive.

On August 6, 2007, our Board of Directors authorized us to proceed with a one-for-three reverse stock split of our outstanding common stock in order to satisfy the minimum bid price requirement for initial listing on The NASDAQ Capital Market. The record date established for the reverse stock split is August 20, 2007. As described in the proxy statement that we filed with the SEC on April 9, 2007, stock and stock equivalents including shares available for issuance under equity compensation plans will be automatically adjusted to reflect the stock split. However, the stock split will not affect our authorized capital stock, which will remain at 50,000,000 shares of common stock and 1,000,000 shares of preferred stock. Our Board reserves the right, exercisable at any time prior to the effectiveness of the stock split, to modify the ratio or record date of the stock split or to not proceed with the stock split.

8. Stock-Based Compensation

Our equity incentive programs include stock options, restricted stock units and deferred stock units. Some awards vest based on continuous service while others vest or accelerate-vest based on performance conditions, such as profitability goals. On January 1, 2006, we adopted SFAS No. 123 (revised), *Share-Based Payment* (SFAS No. 123R), which requires measurement and recognition of compensation expense for all share-based awards made to employees and directors.

Under SFAS No. 123R, the fair value of share-based awards is estimated at grant date using an option pricing model, and the portion that is ultimately expected to vest is recognized as compensation cost over the requisite service period. For awards that vest based on service, we record compensation expense ratably over the service period from the date of grant. For performance-based awards, we begin recording compensation expense over the remaining service period when we determine that achievement is probable. Change in estimates as to the probability of vesting is recorded through cumulative catch-up adjustments when the assessment is made. Since share-based compensation under SFAS No. 123R is recognized only for those awards that are ultimately expected to vest, we have applied an estimated forfeiture rate to unvested awards for the purpose of calculating compensation cost. These estimates will be revised, if necessary, in future periods if actual forfeitures differ from the estimates. Changes in forfeiture estimates impact compensation cost in the period in which the change in estimate occurs. We use the Black-Scholes option-pricing model to estimate the fair value of share-based awards. The determination of fair value using the Black-Scholes option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables, including expected stock price volatility, risk-free interest rate, expected dividends and projected employee stock option exercise behaviors.

9. Inventories

Inventories, consisting of raw materials, work-in-process and finished goods, are stated at the lower of cost or market, with cost determined by the first-in, first-out method. Reserves for slow-moving and obsolete inventories are provided based on historical experience and product demand. We evaluate the adequacy of these reserves periodically.

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The following is a summary of inventories (excluding assets of discontinued operations):

	June 30, 2007	December 31, 2006
Raw materials	$ 1,865	$ 1,750
Work in process	614	300
Finished goods	723	778
Total inventories	3,202	2,828
Less: inventory reserve	(605)	(568)
Inventories, net	$ 2,597	$ 2,260

10. Commitments and Contingencies

Legal Proceedings

Governmental Investigations and Legal Proceedings

As reported in the Form 8-K that we filed on July 20, 2006, we executed a consent to entry of judgment in favor of the SEC on July 14, 2006 and entered into a non-prosecution agreement with the DOJ on July 18, 2006. These two agreements effectively resolve with respect to us the investigations begun by the SEC and by the DOJ in January 2003, regarding allegations that we and certain of our former officers and former directors and one current employee issued, or caused to be issued, false and misleading statements regarding our financial results for 2001 and 2002 and related matters. Under the terms of the consent judgment with the SEC: (i) we paid $750,000 in civil penalties and disgorgement; and (2) we agreed to a stipulated judgment enjoining future violations of securities laws. On April 7, 2006, we entered into an escrow agreement with Morrison & Foerster LLP, our outside counsel, pursuant to which we placed the $750,000 anticipated settlement in escrow with Morrison & Foerster at the request of the SEC staff. The funds were released from the escrow to the SEC in August 2006. A liability for the monetary penalty was accrued in 2004.

The investigations and legal proceedings related to certain former officers and former directors remain ongoing and are not affected by our settlements with the SEC and DOJ. We remain contractually obligated to pay legal fees for and otherwise indemnify these former officers and former directors. On August 9, 2006 the SEC filed civil fraud charges in federal district court against two former officers. On April 9, 2007, these two former officers were indicted by a federal grand jury in Orange County, California. Our directors and officers liability insurance may fund certain losses, including defense costs, related to these matters. As of June 30, 2007, we had $0.3 million in remaining available coverage under the applicable excess directors and officers liability policy. This policy reimburses 75 percent of the first $2.25 million in eligible costs to a maximum of approximately $1.7 million, zero percent of the next $500,000 and 57.5 percent of the next $1 million to a maximum of $0.6 million. For further information regarding this coverage, please refer to the Form 8-K that we filed on February 25, 2005.

Lawsuit with KPMG LLP

On October 26, 2006, we filed a lawsuit with the Superior Court of the State of California for the County of Orange against our former independent auditor, KPMG LLP, for professional negligence and breach of contract, seeking damages in an amount to be determined at trial. Previously, we had entered into a Mediation and Tolling Agreement with KPMG pursuant to which KPMG agreed that the statute of limitations would be tolled to provide an opportunity for mediation between the parties. We engaged in mediation with KPMG on September 27, 2006 but the parties were unable to reach settlement. Accordingly, we proceeded with the filing of the lawsuit. In response to our claims against KPMG, KPMG filed a cross-complaint against us and certain former officers. Under the cross-complaint, KPMG makes claims against us for breach of contract, violations of the federal racketeering statute and conspiracy to violate the federal racketeering statute, seeking damages in an amount to be determined at trial. We are not able to predict the outcome of this lawsuit.

Other Litigation

In January 2006, we entered into a settlement and release agreement with certain parties against whom we had a claim from a judgment awarded to us in prior years. We received $162,500 in the settlement of this claim, which was recorded as a reduction of general and administrative expenses in the first quarter of 2006.

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In addition, in the normal course of business, we are subject to various other legal matters, which we believe will not individually or collectively have a material adverse effect on our consolidated financial condition, results of operations or cash flows. However, the results of litigation and claims cannot be predicted with certainty, and we cannot provide assurance that the outcome of various legal matters will not have a material adverse effect on our consolidated financial condition, results of operations or cash flows. As of June 30, 2007, we have not established a liability for contingencies in the consolidated balance sheets since the likelihood of loss and potential liability cannot be reliably estimated at this time. However, our evaluation of the likelihood of an unfavorable outcome with respect to these actions could change in the future.

From time to time, we have received correspondence alleging infringement of proprietary rights of third parties. No assurance can be given that any relevant claims of third parties would not be upheld as valid and enforceable, and therefore we could be prevented from practicing the subject matter claimed or would be required to obtain licenses from the owners of any such proprietary rights to avoid infringement. We do not expect any material adverse effect on our consolidated financial condition, results of operations or cash flows because of such claims.

11. Income Taxes

On January 1, 2007, we adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, *an interpretation of SFAS No. 109*, *Accounting for Income Taxes* (FIN 48). FIN 48 creates a single model to address accounting for uncertainty in tax positions. It clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition.

As of the adoption date, we had $240,000 of unrecognized tax benefits, all of which would affect our effective tax rate if recognized. A reconciliation of the beginning and ending amount of unrecognized tax benefit is as follows:

Balance as of January 1, 2007	$ 240,000
Additions based on tax positions related to the current year	
Additions for tax positions of prior years	
Reductions for tax positions of prior years	
Settlements	
Balance as of June 30, 2007	$ 240,000

Because of our historical losses, FIN 48 did not have an effect on our accounting and disclosure for income taxes. We do not anticipate that there will be a material change in the balance of the unrecognized tax benefits within the next twelve months. We recognize interest and penalties related to uncertain tax positions in income tax expense. We have approximately $40,000 of accrued interest related to uncertain tax positions as of January 1, 2007 and June 30, 2007. The tax years 2003 through 2006 remain open to examination by the major taxing jurisdictions to which we are subject.

We reported no net income tax expense from continuing and discontinued operations during the three and six months ended June 30, 2007 and 2006 due to our operating losses. The 2006 tax benefit on continuing operations of $0.2 million is the result of the 2006 first quarter pre-tax book losses being utilized against pre-tax book income from discontinued operations. There is an offsetting tax provision within discontinued operations. Due to our history of operating losses, management has determined that it is more likely than not that our deferred tax assets will not be realized through future earnings. Accordingly, valuation allowances were recorded to fully reserve the deferred tax assets as of June 30, 2007 and December 31, 2006.

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12. Results of Operations

Revenues and cost of revenues from continuing operations related to the following products and services for the periods ended June 30, 2007 and 2006 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Revenues:				
Cryoablation disposable products	$ 5,417	$ 3,397	$ 10,620	$ 5,808
Cryocare Surgical Systems	521	225	998	445
Other	115	12	149	22
	6,053	3,634	11,767	6,275
Cryoablation procedure fees	1,746	3,135	3,488	7,598
Cardiac royalties (CryoCath)	102	139	192	297
	$ 7,901	$ 6,908	$ 15,447	$ 14,170
Costs of Revenues:				
Cryoablation disposable products and procedure fees	$ 2,353	$ 3,028	$ 4,746	$ 6,424
Cryocare Surgical Systems	360	228	589	597
	$ 2,713	$ 3,256	$ 5,335	$ 7,021

Cost of revenues for cryoablation disposable product sales and procedure fees are combined for reporting purposes. Sales of cryoablation disposable products and procedure fees both incorporate similar inventory when sold and we do not separately track the cost of disposals sold directly to customers and those consumed in cryoablation procedures. Cryoablation procedure services are provided to medical facilities upon request to facilitate the overall delivery of our technology into the marketplace.

13. Recent Accounting Pronouncements

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the American Institute of Certified Public Accountants, and the SEC did not, or are not believed by management to, have a material impact on our present or future consolidated financial statements.

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

The following discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto included in Part I Item 1 of this report, and the audited consolidated financial statements and notes thereto, and Management s Discussion and Analysis of Financial Condition and Results of Operations contained in the Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

This discussion contains forward-looking statements based on our current expectations. There are various factors many beyond our control that could cause our actual results or the occurrence or timing of expected events to differ materially from those anticipated in these forward-looking statements. Some of these factors are described below and other factors are described elsewhere in this Quarterly Report on Form 10-Q or under Risk Factors in our Annual Report on Form 10-K referred to above. In addition, there are factors not described in this Quarterly Report on Form 10-Q or in our Annual Report on Form 10-K that could cause our actual results or the occurrence or timing of expected events to differ materially from those anticipated in these forward-looking statements. All forward-looking statements included in this Quarterly Report on Form 10-Q are based on information available to us as of the date hereof, and we assume no obligation to update any such forward-looking statements.

Overview

We are an innovative medical device company focused on the development of minimally invasive technologies for tissue and tumor ablation through cryoablation, which is the use of lethal ice to destroy tissue, such as tumors, for therapeutic purposes. We develop and manufacture devices for the treatment of prostate and renal cancers and we believe that our proprietary technologies have broad applications across a number of markets, including the ablation of tumors in the lung and liver and palliative intervention (treatment of pain associated with metastases).

Today, our FDA-cleared Cryocare Surgical System occupies a growing position in the urological market for treatment of prostate and renal cancers. Because of our initial concentration on prostate and renal cancers, the majority of our sales and marketing resources are directed toward the promotion of our technology to urologists. In addition to selling our cryosurgical disposable products to hospitals and mobile service companies, we contract

directly with hospitals for the use of our Cryocare Surgical System and disposable products on a fee-for-service basis. Since 2003, we also maintain a dedicated sales team focused on selling percutaneous cryoablation procedures related to liver, kidney and lung cancer and palliative intervention to interventional radiology physicians throughout the United States. We intend to continue to identify and develop new markets for our cryosurgical products and technologies, particularly in the area of tumor ablation.

We previously owned Timm Medical Technologies, Inc. (Timm Medical), a company focused on erectile dysfunction products. We sold Timm Medical to United Kingdom-based Plethora Solutions Holdings plc effective on February 10, 2006.

Strategy, Key Metrics and Developments

Our primary objective is to grow market share, currently measured in terms of the estimated number of procedures performed with our Cryocare Surgical System, which we calculate using two primary components. The first component is the actual number of cryoablation cases for which we provide the cryoablation products for a treatment and are also responsible for performing the service element on behalf of the healthcare facility. Cryoablation services generally consist of rental and transport of a Cryocare Surgical System as well as the service of a technician to assist the physician with the setup and monitoring of the equipment. In the second, we compute an estimated cryoablation case equivalent based on direct sales of our cryoablation disposable products (without the service component) by using the expected disposable product usage for those sales. Estimated procedure growth has been an important metric to which we have referred during the past several years in order to measure the success of our strategy.

In addition to being a key business metric, procedure growth has been an important driver of revenue growth, because a significant percentage of our revenue consists of sales of the disposable products used in procedures performed with the Cryocare Surgical System, as shown below under Results of Operations. In 2003 we redirected our strategy for our cryoablation business away from emphasizing sales of Cryocare Surgical Systems and instead toward seeking to increase sales of cryoablation disposable products. Historically, we were responsible for performing the service element of the procedure on behalf of the healthcare facility for the majority of our reported procedures. Beginning in 2004, we changed our business model to emphasize our strength as a medical device manufacturer and strategically reduced the amount of revenues attributable to the service model where we are responsible for performing the service element of the procedures on behalf of the healthcare facility for a procedure fee. By the fourth quarter of 2006, we had achieved our goal of having the substantial majority of our procedures comprised of sales of cryoablation disposable products without the service element. During 2006, we succeeded in causing the percentage of total estimated domestic cryoablation procedures for which we perform the service element to decline from 50 percent of total reported procedures for the three months ended March 31, 2006 to 20 percent of total reported procedures for the three months ended December 31, 2006. During the three months ended June 30, 2007, the percentage for which we performed the service element of the procedure declined further to 15 percent of total reported procedures.

Given that we have accomplished the business model transition mentioned above, the majority of our revenues are from sales of cryoablation disposable products and we will again be able to view revenue growth as an important business metric going forward. One result of our new model is that our customers hospitals and third-party service providers are now carrying inventories of our probes and other equipment for use in performing cryoablation procedures. Because of the variability of probe use across patients and applications, determining precisely how many procedures are performed based on sales of cryoablation disposable products is becoming more difficult. Because we are less involved in providing the service element of the procedure, we also will have less ability to ensure that we receive accurate case information in order to validate the assumptions we use about how many cryoprobes are used in an average procedure. Accordingly, we have decided that beginning in the fourth quarter of 2007 and going forward, in addition to revenues, we will begin to provide alternative business metrics such as the number of cryoprobes sold during the period. We believe that these measurements can provide more useful data to the investment community and other users of our financial statements and will allow us to be more precise with the data we provide.

For periods through the end of 2007, we will continue to report estimated procedure numbers and the estimated growth rates of those procedures over prior periods.

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The change in our business model and revenue mix discussed above also has impacted our gross margin due to the disparity in per-procedure revenue between cases for which we are responsible for providing the service element and cases for which we merely sell disposable products. This disparity results from the fact that the revenue from a case for which we merely sell disposable products is less than the revenue from a case for which we are also responsible for providing the service element (referred to as procedure fees below). As the percentage of cases for which we merely sell disposable products increases relative to cases for which we are responsible for providing the service element, our incremental revenues grow at a slower rate than our overall procedure growth. However, the gross profit realized is generally equivalent since we do not incur fees to third party subcontractors for cases for which we merely sell disposable products. In contrast, in cases for which we are responsible for providing the service element, we typically subcontract with a third party service provider to provide the service element on our behalf and thereby incur service fees. As a result, our gross margin (gross profit as a percent of revenues) increases as we shift from procedure fees to sale of disposable products. As a result of this shift, over time, we expect the number of procedures performed to become a less important measure of our business and our revenues to become a more important metric.

In the past several years, we have been successful in increasing the estimated number of domestic cryoablation procedures on a year-over-year basis. In 2005 total estimated procedures increased 36 percent to 6,407 from 4,713 in 2004. In 2006 total estimated procedures increased 22 percent to 7,802. During the three months ended June 30, 2007, total estimated procedures increased 26 percent to 2,435 from 1,938 in the three months ended June 30, 2006. During the six months ended June 30, 2007, total estimated procedures increased 28 percent to 4,750 from 3,699 in the prior year period.

The factors driving interest in and utilization of cryoablation by urologists include increased awareness and acceptance of cryoablation by physicians and industry thought leaders, continued publication of clinical follow up data on the effectiveness of cryoablation, including 10-year data presented in 2005, increased awareness among patients of cryoablation and its preferred outcomes as compared to other modalities, the efforts of our dedicated cryoablation sales force and our continued expenditure of funds on physician training as well as patient education and advocacy.

We believe that one of the factors that adversely impacts procedure growth and revenues is that certain urologists decide from time to time to try new techniques for the treatment of prostate cancer. We cannot predict the extent to which this factor may continue to affect us. However, the prostate cancer treatment market is very competitive and there are many different treatment options that have been developed and that are continuing to be developed.

Results of Operations

Revenues and costs of revenues from continuing operations related to the following products and services for the three and six months ended June 30, 2007 and 2006 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Revenues:				
Cryoablation disposable products	$ 5,417	$ 3,397	$ 10,620	$ 5,808
Cryocare Surgical Systems	521	225	998	445
Other	115	12	149	22
	6,053	3,634	11,767	6,275
Cryoablation procedure fees	1,746	3,135	3,488	7,598
Cardiac royalties (CryoCath)	102	139	192	297
	$ 7,901	$ 6,908	$ 15,447	$ 14,170
Costs of Revenues:				
Cryoablation disposable products and procedure fees	$ 2,353	$ 3,028	$ 4,746	$ 6,424

Cryocare Surgical Systems	360	228	589	597
	$ 2,713	$ 3,256	$ 5,335	$ 7,021

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Costs of revenues for cryoablation disposable products and procedure fees are combined for reporting purposes. Sales of cryoablation disposable products and procedure fees incorporate similar inventory when sold and we do not separately track the cost of disposable products sold directly to customers and those consumed in cryoablation procedures.

We recognize revenues from sales of Cryocare Surgical Systems and disposable cryoprobes when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed and determinable, and collectibility is reasonably assured. Per-procedure fees are recorded when the service has been rendered.

Costs of revenues consist of fixed and variable costs incurred in the manufacture of our products in addition to depreciation of Cryocare Surgical Systems placed in the field with customers under our placement program or with our sales and service personnel. We incur an additional cost of revenues in the form of a fee for equipment usage and other services when a procedure is performed on a system owned by an unrelated service provider. The fee paid to the third-party service provider is charged to costs of revenues when the procedure is performed and billed.

Research and development expenses include expenses associated with the design and development of new products as well as enhancements to existing products. We expense research and development costs when incurred. Our research and development efforts are occasionally subject to significant non-recurring expenses and fees that can cause some variability in our quarterly research and development expenses.

Selling and marketing expenses primarily consist of salaries, commissions and related benefits and overhead costs for employees and activities in the areas of selling, marketing and customer service. Expenses associated with advertising, trade shows, promotional and physician training costs related to marketing our products are also classified as selling and marketing expenses.

General and administrative expenses primarily consist of salaries and related benefits and overhead costs for employees and activities in the areas of legal affairs, finance, information technology, human resources and administration. Fees for attorneys, independent auditors and certain other outside consultants are also included where their services are related to general and administrative activities. This category also includes reserves for bad debt and litigation losses less amounts recoverable under our insurance policies. Litigation reserves and insurance recoveries are recorded when such amounts are probable and can be reasonably estimated.

Effective January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share Based Payment* (SFAS No. 123R) using the modified-prospective transition method. Under that transition method, compensation cost recognized in the six months ended June 30, 2007 and 2006 included (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006 based on the grant date fair value estimated in accordance with the original provisions of SFAS 123 and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimate in accordance with the provisions of SFAS 123R. As of June 30, 2007, there was $2.6 million of total unrecognized compensation costs related to stock options and $2.8 million related to restricted stock units. The stock-option compensation cost is expected to be amortized on a straight-line basis over a weighted average period of 1.08 years less any stock options forfeited prior to vesting. Compensation costs related to restricted stock units will be recorded over the remaining service period (2007 through 2009) if it is probable the performance conditions (Profitability Goals) will be satisfied. No expense related to these performance based awards has been recorded as of June 30, 2007.

Three Months Ended June 30, 2007 Compared to Three Months Ended June 30, 2006

Revenues

	Three Months Ended June 30,			
(dollars in thousands)	**2007**	**2006**	**$ Change**	**% Change**
Cryoablation disposable products	$ 5,417	$ 3,397	$ 2,020	59.5%
Cryocare Surgical Systems	521	225	296	131.6%
Other	115	12	103	858.3%

	6,053	3,634	2,419	66.6%
Cryoablation procedure fees	1,746	3,135	(1,389)	(44.3)%
Cardiac royalties (CryoCath)	102	139	(37)	(26.6)%
	$ 7,901	$ 6,908	$ 993	14.4%

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Although our total number of estimated procedures increased approximately 26 percent to 2,435 from 1,938 for the three months ended June 30, 2007 compared to June 30, 2006, our increase in revenue is not reflective of this increase because of our change in revenue mix. Generally, we earn less revenue per estimated case for sales of cryoablation disposable products than for procedure fees; however the related gross margin as a percent of revenues for sales of cryoablation disposable products is greater. Of the total estimated procedures performed during the three months ended June 30, 2007, 15 percent were those for which we provided cryoablation services and 85 percent were from the sale of cryoablation disposable products. This compares to 33 percent for cryoablation services and 67 percent for sales of cryoablation disposable products during the three months ended June 30, 2006.

Also contributing to growth in sales of cryoablation products was an increase in sales to a market served by interventional radiologists, treating tumors in the kidney, lung and liver and palliative intervention. Direct sales of disposable products and interventional radiology procedures generally have a lower average selling price than procedures performed by urologists on prostate and renal treatments although costs of revenues are also lower.

Cardiac royalty revenues decreased for the three months ended June 30, 2007 over the same period in 2006. The contractual rate of royalties CryoCath is obligated to pay us as a percentage of related revenues decreased from 5.0 percent in 2006 to 3.0 percent in 2007.

Revenues from sales of Cryocare Surgical Systems increased primarily due to increased international sales of our systems.

Cost of Revenues

	Three Months Ended June 30,		
(dollars in thousands)	**2007**	**2006**	**$ Change**
Three months ended	$2,713	$3,256	$(543)
Percent of revenues	34.3%	47.1%	

The decrease in cost of revenues resulted primarily from the change in the mix of our revenues from those where we are responsible for providing cryoablation procedure services to solely selling cryoablation disposable products. This mix shift led to a decrease in the number of cases for which we paid fees to third party service providers. In addition, costs of revenues declined due to decreases in materials, labor and overhead costs. During the three months ended June 30, 2007 and 2006, substantially all of our cryoablation procedures for which we were responsible for the service element were performed by third party service providers at an additional cost to us.

Gross Profit and Gross Margin

	Three Months Ended June 30,		
(dollars in thousands)	**2007**	**2006**	**$ Change**
Cryoablation disposable products and procedure fees	$ 4,810	$ 3,504	$ 1,306
Cryocare surgical systems	161	(3)	164
Cardiac royalties (CryoCath) and other	217	151	66
	$ 5,188	$ 3,652	$ 1,536

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(percent of revenues)	Three Months Ended June 30, 2007	2006	Percentage Point Change
Cryoablation disposable products and procedure fees	60.9%	50.7%	10.2%
Cryocare Surgical Systems	2.0%		2.0%
Cardiac royalties (CryoCath)	2.8%	2.2%	0.6%
	65.7%	52.9%	12.8%

The positive trend in gross margins (gross profit as a percentage of revenues) was primarily related to our shift from procedures where we bear responsibility for the service element of the procedure to those where we solely sell our cryoablation disposable products. Sales of cryoablation disposable products yield a higher gross margin than procedures performed by third party subcontractors. We also have continued to reduce manufacturing costs for our cryoablation disposable products, while increasing efficiencies in production.

Research and Development Expenses

(dollars in thousands)	Three Months Ended June 30, 2007	2006	$ Change	% Change
Research and development expenses	$621	$475	$146	30.7%
Percent of total revenues	7.9%	6.9%		

This increase is primarily attributable to expenses related to clinical studies, which are generally recognized in conjunction with milestones inherent in the studies and enrollment of patients, and as such are not always predictable in amount and timing. In 2007, we are focusing our research dollars on those areas in which cryoablation research is required to substantiate reimbursement codes and coverage. The 2007 increase in clinical studies expense was partially offset by a reduction in consulting, engineering supplies and stock-based compensation.

Selling and Marketing Expenses

(dollars in thousands)	Three Months Ended June 30, 2007	2006	$ Change	% Change
Selling and marketing expenses	$4,099	$3,904	$195	5.0%
Percent of total revenues	51.9%	56.5%		

Our efforts to reduce costs have been effective resulting in reductions in travel and entertainment costs, consulting costs and advertising, trade shows and related expenses totaling $0.2 million for the three months ended June 30, 2007. However, due mainly to the increased revenues in the current quarter over the same period last year, our cash compensation related costs increased $0.5 million. Included in selling and marketing expenses for the three months ended June 30, 2007 and 2006 were $0.1 million and $0.2 million in non-cash stock-based compensation expense, respectively.

General and Administrative Expenses

(dollars in thousands)	Three Months Ended June 30, 2007	2006	$ Change	% Change

General and administrative expenses	$2,845	$2,072	$773	37.3%
Percent of total revenues	36.0%	30.0%		

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The 2007 and 2006 periods included a $0.1 million and $0.9 million reduction in accrued payroll taxes pertaining to employee loans forgiven and stock option exercises that occurred in 2002 and prior, which was no longer statutorily due. Also included in general and administrative expenses for each of the quarters ended June 30, 2007 and June 30, 2006 was $0.7 million of non-cash stock-based compensation expense**.**

Interest Expense Related to Common Stock Warrants.

	Three Months Ended June 30,			
(dollars in thousands)	**2007**	**2006**	**$ Change**	**% Change**
Interest expense related to common stock warrants	$	$(1,908)	$(1,908)	(100.0%)
Percent of total revenues		(27.6)%		

Interest expense related to common stock warrants resulted from the decrease in the fair value of common stock warrants in connection with our March 2005 private placement. As a result of a provision for liquidated damages under a related registration rights agreement, these warrants were accounted for as derivatives through December 31, 2006 and were carried at fair value with changes in fair value recorded through interest expense. Effective January 1, 2007, we adopted FASB Staff Position (FSP) No. 00-19-02, *Accounting for Registration Payment Arrangements*, which no longer requires the warrants to be recorded as derivatives and no interest expense was recorded for these warrants during the three months ended June 30, 2007. See Note 5 *Private Placement of Common Stock and Warrants* for further discussion.

Interest Income, Net

	Three Months Ended June 30,			
(dollars in thousands)	**2007**	**2006**	**$ Change**	**% Change**
Interest income, net	$113	$183	$(70)	(38.3)%
Percent of total revenues	1.4%	2.6%		

Interest income, net in the 2007 and 2006 periods includes interest income on a note receivable for the 2003 sale of our urinary incontinence product line and interest income earned from the investment of our cash balances.

Net Loss

	Three Months Ended June 30,			
(dollars in thousands)	**2007**	**2006**	**$ Change**	**% Change**
Net loss	$(2,264)	$ (708)	$1,556	219.8%
Percent of total revenues	(28.7)%	(10.2)%		

Net loss for the three months ended June 30, 2007 was $0.07 per basic and diluted share on 32.7 million weighted average shares outstanding, compared to a net loss of $0.02 per basic and diluted share on 30.2 million weighted average shares outstanding during the same period in 2006.

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Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2006

Revenues

	Six Months Ended June 30,			
(dollars in thousands)	**2007**	**2006**	**$ Change**	**% Change**
Cryoablation disposable products	$ 10,620	$ 5,808	$ 4,812	82.9%
Cryocare Surgical Systems	998	445	553	124.3%
Other	149	22	127	577.3%
	11,767	6,275	5,492	87.5%
Cryoablation procedure fees	3,488	7,598	(4,110)	(54.1)%
Cardiac royalties (CryoCath)	192	297	(105)	(35.4)%
	$ 15,447	$ 14,170	$ 1,277	9.0%

Although our total number of estimated procedures increased approximately 28 percent to 4,750 from 3,699 for the six months ended June 30, 2007 compared to June 30, 2006, our increase in revenue is not reflective of this increase because of our change in revenue mix. Generally, we earn less revenue per estimated case for sales of cryoablation disposable products than for procedure fees; however the related gross margin as a percent of revenues for sales of cryoablation disposable products is greater. Of the total estimated procedures performed during the six months ended June 30, 2007, 15 percent were those for which we provided cryoablation services and 85 percent were from the sale of cryoablation disposable products. This compares to 41 percent for cryoablation services and 59 percent for sales of cryoablation disposable products during the six months ended June 30, 2006.

Also contributing to growth in sales of cryoablation products was an increase in sales to a market served by interventional radiologists, treating tumors in the kidney, lung and liver and palliative intervention. Direct sales of disposable products and interventional radiology procedures generally have a lower average selling price than procedures performed by urologists on prostate and renal treatments although costs of revenues are also lower.

Cardiac royalty revenues decreased for the six months ended June 30, 2007 over the same period in 2006. The contractual rate of royalties CryoCath is obligated to pay us as a percentage of related revenues decreased from 5.0 percent in 2006 to 3.0 percent in 2007.

Revenues from sales of Cryocare Surgical Systems increased primarily due to increased international sales of our systems.

Cost of Revenues

	Six Months Ended June 30,		
(dollars in thousands)	**2007**	**2006**	**$ Change**
Six months ended	$5,335	$7,021	$(1,686)
Percent of revenues	34.5%	49.5%	

The decrease in cost of revenues resulted primarily from the change in the mix of our revenues from those where we are responsible for providing cryoablation procedure services to solely selling cryoablation disposable products. This mix shift led to a decrease in the number of cases for which we paid fees to third party service providers. In addition, costs of revenues declined due to decreases in materials, labor and overhead costs. During the six months ended June 30, 2007 and 2006, substantially all of our cryoablation procedures for which we were responsible for the service element were performed by third party service providers at an additional cost to us.

Gross Profit and Gross Margin

(dollars in thousands)	Six Months Ended June 30, 2007	2006	$ Change
Cryoablation disposable products and procedure fees	$ 9,362	$ 6,982	$ 2,380
Cryocare surgical systems	409	(152)	561
Cardiac royalties (CryoCath) and other	341	319	22
	$ 10,112	$ 7,149	$ 2,963

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(percent of revenues)	Six Months Ended June 30, 2007	2006	Percentage Point Change
Cryoablation disposable products and procedure fees	60.6%	49.3%	11.3%
Cryocare surgical systems	2.7%	(1.1%)	3.8%
Cardiac royalties (CryoCath) and other	2.2%	2.3%	(0.1)%
	65.5%	50.5%	15.0%

The positive trend in gross margins (gross profit as a percentage of revenues) was primarily related to our shift from procedures where we bear responsibility for the service element of the procedure to those where we solely sell our cryoablation disposable products. Sales of cryoablation disposable products yield a higher gross margin than procedures performed by third party subcontractors. We also have continued to reduce manufacturing costs for our cryoablation disposable products, while increasing efficiencies in production.

Research and Development Expenses

(dollars in thousands)	Six Months Ended June 30, 2007	2006	$ Change	% Change
Research and development expenses	$1,236	$1,486	$(250)	(16.8)%
Percent of total revenues	8.0%	10.5%		

This decrease is primarily attributable to a $0.2 million reduction in educational grants and clinical studies expenses. In 2007, we are focusing our research dollars on those areas in which cryoablation research is required to substantiate reimbursement codes and coverage. In addition, these expenses are generally recognized in conjunction with milestones inherent in the studies and as such are not always predictable in amount and timing. Also contributing to the decrease is a reduction in consulting, engineering supplies and stock-based compensation.

Selling and Marketing Expenses

(dollars in thousands)	Six Months Ended June 30, 2007	2006	$ Change	% Change
Selling and marketing expenses	$7,862	$7,673	$189	2.5%
Percent of total revenues	50.9%	54.1%		

Our efforts to reduce costs have been effective resulting in reductions in travel and entertainment costs, consulting costs and advertising, trade shows and related expenses totaling $0.5 million for the six months ended June 30, 2007. However, due mainly to the increased revenues in the current six month period over the same period last year, our cash compensation related costs increased $0.9 million. Included in selling and marketing expenses for the six months ended June 30, 2007 and 2006 were $0.2 million and $0.4 million in non-cash stock-based compensation expense, respectively.

General and Administrative Expenses

(dollars in thousands)	Six Months Ended June 30, 2007	2006	$ Change	% Change
General and administrative expenses	$6,674	$6,067	$607	10.0%
Percent of total revenues	43.2%	42.8%		

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This increase is primarily due to increased legal fees generated by the law firms representing the former officers and former directors in connection with the ongoing SEC and DOJ matters, as well as legal action taken against KPMG as described in Note 10 *Commitments and Contingencies.* The legal fees, net of insurance reimbursement, incurred during the six months ended June 30, 2007 were $0.4 million greater than those incurred during the six months ended June 30, 2006. In addition, legal fees related to legal action against KPMG were $0.3 million during 2007. Included in general and administrative expenses during the 2007 and 2006 period was a $0.1 million and $0.9 million reduction in accrued payroll taxes pertaining to employee loans forgiven and stock option exercises that occurred in 2002 and prior, which was no longer statutorily due. As a result of our concerted effort to reduce costs, our audit, accounting and consulting fees decreased by over $0.6 million for the six months ended June 30, 2007 as compared to the same period in 2006. Also offsetting the increased legal and payroll tax expense is the recovery of previously unbilled sales and use taxes from liable customers of $0.2 million. Also included in general and administrative expenses for each of the six months ended June 30, 2007 and June 30, 2006 was $1.3 million of non-cash stock-based compensation expense**.**

Interest Expense Related to Common Stock Warrants

	Six Months Ended June 30,			
(dollars in thousands)	**2007**	**2006**	**$ Change**	**% Change**
Interest expense related to common stock warrants	$	$(1,696)	$(1,696)	(100.0%)
Percent of total revenues		(12.0%)		

Interest expense related to common stock warrants resulted from the decrease in the fair value of common stock warrants related to our March 2005 private placement. As a result of a provision for liquidated damages under a related registration rights agreement, these warrants were accounted for as derivatives through December 31, 2006 and were carried at fair value with changes in fair value recorded through interest expense. Effective January 1, 2007, we adopted FASB Staff Position (FSP) No. 00-19-02, *Accounting for Registration Payment Arrangements*, which no longer requires the warrants to be recorded as derivatives and no interest expense was recorded for these warrants during the six months ended June 30, 2007. See Note 5 *Private Placement of Common Stock and Warrants* for further discussion.

Interest Income, Net

	Six Months Ended June 30,			
(dollars in thousands)	**2007**	**2006**	**$ Change**	**% Change**
Interest income, net	$139	$349	$(210)	(60.2)%
Percent of total revenues	0.9%	2.5%		

Interest income, net in the 2007 and 2006 periods includes interest income on a note receivable for the 2003 sale of our urinary incontinence product line and interest income earned from the investment of our cash balances.

Net Loss

	Six Months Ended June 30,			
(dollars in thousands)	**2007**	**2006**	**$ Change**	**% Change**
Net loss	$(5,521)	$(5,636)	$(115)	(2.0)%
Percent of total revenues	(35.7)%	(39.8)%		

Net loss for the six ended June 30, 2007 was $0.17 per basic and diluted share on 31.9 million weighted average shares outstanding, compared to a net loss of $0.19 per basic and diluted share on 30.2 million weighted average shares outstanding during the same period in 2006.

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Liquidity and Capital Resources

Since inception, we have incurred losses from operations and have reported negative cash flows. As of June 30, 2007, we had an accumulated deficit of $186.3 million and cash and cash equivalents of $7.2 million.

We do not expect to reach cash flow positive operations in 2007, and we expect to continue to generate losses from operations for the foreseeable future. These losses have resulted in part from our continued investment to gain acceptance of our technology and investments in initiatives that we believe should ultimately result in cost reductions. Although in July 2006 we resolved the investigations by the SEC and DOJ of our historical accounting and financial reporting (see Note 10 *Commitments and Contingencies*), we still have obligations to indemnify and advance the legal fees of our former officers and former directors in connection with the ongoing investigations and legal proceedings related to those individuals. The amount of those legal fees may exceed the reimbursement due to us from our directors and officers liability insurance, and the excess may have a material adverse effect on our business, financial condition, results of operations and liquidity. For the six months ended June 30, 2007, we incurred expenses of $1.0 million relating to legal fees of former officers and former directors, and recorded insurance recoveries of $0.7 million. As of June 30, 2007, there remained an aggregate of $0.3 million available under this insurance coverage. For a description of this insurance coverage, please refer to the Form 8-K that we filed on February 25, 2005 and Note 10 *Commitments and Contingencies.*

We also face large cash expenditures in the future related to past due state and local taxes, primarily sales and use tax obligations, which we estimate to be approximately $2.5 million and which was accrued as of June 30, 2007. We are in the process of negotiating resolutions of the past due state and local tax obligations with the applicable tax authorities.

As discussed in Note 5 *Private Placement of Common Stock and Warrants,* on October 25, 2006, we entered into an agreement with Fusion Capital which gives us the right to sell to Fusion Capital up to $16.0 million of common stock over a two year period at prices determined based upon the market price of our common stock at the time of each sale without any fixed discount (in $100,000 increments every fourth business day, with additional $150,000 increments available every third business day if the market price per share of our common stock is $1.50 or higher), subject to our ability to comply with certain ongoing requirements. These requirements include, among others, maintaining effectiveness of the registration statement covering the sale of the shares purchased by Fusion Capital, and maintenance of per share trading prices at or above $1.00. The $150,000 increment can be increased if the market price of our common stock increases. The SEC declared the registration statement effective on December 1, 2006.

Through June 30, 2007 we have sold 880,191 shares of stock to Fusion Capital for total gross proceeds of $1.6 million. Since we have authorized 8,000,000 shares for sale under the stock purchase agreement, the selling price of our common stock to Fusion Capital would have had to average at least $2.00 per share for us to receive the maximum proceeds of $16.0 million.

On May 24, 2007 we sold 3,255,814 shares of our common stock to Frazier Healthcare V, L.P. at a price per share of $2.15, for aggregate proceeds of $7.0 million.

We will use existing cash reserves, as well as future proceeds from sales, if any, of common stock to Fusion Capital, to finance our projected operating and cash flow needs, along with continued expense management efforts. In addition, we may borrow funds under our line of credit with our bank as long as we remain in compliance with the representations, warranties, covenants and borrowing conditions set forth in the agreements governing the line of credit. The funds we can borrow are based on eligible trade receivables and inventory as defined. The credit facility includes a subjective acceleration clause and a requirement to maintain a lock box with the lender, the proceeds from which will be applied to reduce the outstanding borrowings upon our default or if other conditions are met. We were not in compliance with the minimum tangible net worth covenant under our bank line of credit for the months of September to November 2006. On December 22, 2006, we signed an amendment to the Loan and Security Agreement. Among other things, the amendment (i) modifies the borrowing base to increase the eligible accounts receivable from 80 percent to 85 percent and modifies the definition of accounts that are ineligible under the borrowing base calculation; (ii) modifies the loan margin as defined to 1.50 percent, and (iii) waives non-

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compliance with the minimum tangible net worth requirement as of September 30, 2006, October 31, 2006 and November 30, 2006, as well as modifies the terms of the covenant. As of December 31, 2006 and June 30, 2007, we were in compliance with all covenants. On February 23, 2007, the credit agreement was amended to further modify the minimum tangible net worth provision and to extend the maturity date to February 27, 2008. As of June 30, 2007 we had $1.1 million outstanding on the line of credit. During February through May 2007, outstanding advances exceeded 50 percent of the accounts receivable borrowing base referred to above. As required by the agreement, our lock-box proceeds were applied daily to reduce the outstanding advances and we re-borrow the amount subject to the lender s approval through June 30, 2007. As of July 13, 2007, we were no longer required to repay and re-borrow funds on a daily basis.

Our cash needs are not entirely predictable and the future availability of funds from Fusion Capital and our bank is subject to many conditions, including certain subjective acceleration clauses and other provisions, some of which are predicated on events that are not within our control. Accordingly, we cannot guarantee the availability of these capital resources or that they will be sufficient to fund our ongoing operations to the point where our operations will generate positive cash flows.

However, we believe that the Fusion Capital financing and bank line of credit, together with the $7.0 million that we received from Frazier Healthcare V, L.P., should provide us with the capital resources that we need to reach the point where our operations will generate positive cash flows.

Item 3. ***Quantitative and Qualitative Disclosures About Market Risk***

The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive from our invested cash without significantly increasing risk of loss. Our financial instruments include cash, cash equivalents, accounts and notes receivable, minority investments, accounts payable, accrued liabilities and bank debt. As of June 30, 2007, the carrying values of our financial instruments approximated their fair values. Our policy is not to enter into derivative financial instruments. In addition, we do not enter into any futures or forward contracts and therefore we do not have significant market risk exposure with respect to commodity prices.

Although we transact our business in U.S. dollars, future fluctuations in the value of the U.S. dollar may affect the price competitiveness of our products. However, we do not believe that we currently have any significant direct foreign currency exchange rate risk and have not hedged exposures denominated in foreign currencies or any other derivative financial instruments.

Item 4. ***Controls and Procedures***

(a) *Evaluation of Disclosure Controls and Procedures.* We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports pursuant to the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended, we carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the quarter covered by this report. Based on the foregoing, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

(b) *Changes in Internal Controls.* There was no change in our internal control over financial reporting during our second fiscal quarter for 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. ***Legal Proceedings***

Please refer to the legal proceedings described in Part I, Item 3, Legal Proceedings in the Form 10-K that we filed on March 16, 2007 and in Part II, Item 1, Legal Proceedings in the Form 10-Q that we filed on May 9, 2007. There have been no new reportable legal proceedings or material developments since the prior quarter.

Item 1A. ***Risk Factors***

Please see our 2006 Annual Report on Form 10-K filed with the SEC on March 16, 2007, which includes a detailed discussion of our risk factors. There have been no material changes in our risk factors from those disclosed in the Form 10-K, except for updating the following risk factor:

In order to qualify our stock for relisting, our Board has approved a one-for-three reverse stock split to be become effective on August 20, 2007; this reverse stock split could adversely affect our stockholders.

In order to qualify our stock for relisting, we may effectuate a reverse stock split. AMEX requires a minimum bid price of $2.00, The NASDAQ Capital Market requires a minimum bid price of $4.00 and The NASDAQ Global Market requires a minimum bid price of $5.00. As of July 31, 2007, the closing price for our common stock as reported on the OTC Bulletin Board was $2.48 per share. Our stockholders have authorized us to effectuate a reverse stock split at any time until May 10, 2009. The authorization allows for an exchange ratio ranging from one-to-two to one-to-five, including any fraction within that range. On August 6, 2007, our Board of Directors approved a one-for-three reverse stock split to become effective after the close of the market on August 20, 2007 in order to enable us to satisfy the $4.00 minimum bid price requirement of The NASDAQ Capital Market. In many instances historically the markets have reacted negatively to the effectuation of a reverse stock split. The trading price of our stock may be negatively affected by the reverse stock split.

Item 2. ***Unregistered Sales of Equity Securities and Use of Proceeds***

None, except as previously reported.

Item 3. ***Defaults Upon Senior Securities***

Not applicable.

Item 4. ***Submission of Matters to a Vote of Security Holders***

We held our Annual Meeting of Stockholders on Thursday, May 10, 2007. Our stockholders approved the following matters at the Annual Meeting by the votes indicated:

1. The stockholders elected the following six directors to our Board of Directors to serve until the 2008 Annual Meeting of Stockholders or until their respective successors are duly elected and qualified:

	Number of Shares	
	For	**Abstain**
John R. Daniels, M.D.	22,758,048	165,667
Craig T. Davenport	22,651,648	272,067
David L. Goldsmith	22,707,348	216,367
Eric S. Kentor	22,758,048	165,667
Terrence A. Noonan	22,707,848	215,867
Thomas R. Testman	22,757,348	166,367

2. The stockholders voted to authorize our Board of Directors, in its discretion, to amend our Restated Certificate of Incorporation to effectuate a reverse stock split of our common stock, at an exchange ratio ranging from one-to-two to one-to-five, including any fraction within that range, at any time before May 10, 2009:

	Number of Shares
For	21,747,512
Against	748,600
Abstain	427,603

3. The stockholders ratified the selection of Ernst & Young LLP as our independent auditor for the fiscal year ending December 31, 2007:

	Number of Shares
For	22,751,715
Against	140,925
Abstain	31,075

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Item 5. ***Other Information***

None.

Item 6. ***Exhibits***

A list of exhibits to this Form 10-Q is found in the Exhibit Index immediately following the Signature Page of this Form 10-Q, which is hereby incorporated by reference herein.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

ENDOCARE, INC.

By: /s/ CRAIG T. DAVENPORT
Craig T. Davenport
Chief Executive Officer, President and Chairman of the Board
(Duly Authorized Officer)

By: /s/ MICHAEL R. RODRIGUEZ
Michael R. Rodriguez
Senior Vice President, Finance and Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: August 6, 2007

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EXHIBIT INDEX

Exhibit No.	Description
2.1(1)	Stock Purchase Agreement, dated as of January 13, 2006, by and among the Company, Plethora Solutions Holdings plc and Timm Medical Technologies, Inc. The schedules and other attachments to this exhibit were omitted. The Company agrees to furnish a copy of any omitted schedules or attachments to the Securities and Exchange Commission upon request.
2.2(2)	$1,425,000 Secured Convertible Promissory Note, dated as of February 10, 2006, from Plethora Solutions Holdings plc to the Company.
3.1(3)	Certificate of Amendment of Restated Certificate of Incorporation of the Company.
3.2(3)	Certificate of Designation of Series A Junior Participating Preferred Stock of the Company.
3.3(3)	Restated Certificate of Incorporation.
3.4(4)	Amended and Restated Bylaws of the Company.
4.1(5)	Form of Stock Certificate.
4.2(6)	Form of Series A Warrant.
4.3(6)	Form of Series B Warrant.
4.4(7)	Rights Agreement, dated as of March 31, 1999, between the Company and U.S. Stock Transfer Corporation, which includes the form of Certificate of Designation for the Series A Junior Participating Preferred Stock as Exhibit A, the form of Rights Certificate as Exhibit B and the Summary of Rights to Purchase Series A Preferred Shares as Exhibit C.
4.5(8)	Amendment No. 1 to Rights Agreement, dated as of September 24, 2005, between the Company and U.S. Stock Transfer Corporation.
10.1(9)	Common Stock Subscription Agreement, dated as of May 24, 2007, by and between Endocare, Inc. and Frazier Healthcare V, L.P.
10.2(9)	Registration Rights Agreement, dated as of May 25, 2007, by and between Endocare, Inc. and Frazier Healthcare V, L.P.
31.1	Certification under Section 302 of the Sarbanes-Oxley Act of 2002 for Craig T. Davenport.
31.2	Certification under Section 302 of the Sarbanes-Oxley Act of 2002 for Michael R. Rodriguez.
32.1	Certification under Section 906 of the Sarbanes-Oxley Act of 2002 for Craig T. Davenport.
32.2	Certification under Section 906 of the Sarbanes-Oxley Act of 2002 for Michael R. Rodriguez.

(1) Previously filed as an exhibit to our Form 8-K filed on January 18, 2006.

(2) Previously filed as an exhibit to our Form 10-K filed on March 16, 2006.

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(3) Previously filed as an exhibit to our Registration Statement on Form S-3 filed on September 20, 2001.

(4) Previously filed as an exhibit to our Form 10-K filed on March 15, 2004.

(5) Previously filed as an exhibit to our Form 10-K for the year ended December 31, 1995.

(6) Previously filed as an exhibit to our Form 8-K filed on March 16, 2005.

(7) Previously filed as an exhibit to our Form 8-K filed on June 3, 1999.

(8) Previously filed as an exhibit to our Form 8-K filed on June 28, 2005.

(9) Previously filed as an exhibit to our Form 8-K filed on May 29, 2007