CARDIOGENESIS CORP /CA
Form 10-K/A
July 13, 2001

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

AMENDMENT NO. 3
TO
FORM 10-K

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2000
COMMISSION FILE NUMBER: 0-28288

CARDIOGENESIS CORPORATION
(formerly known as Eclipse Surgical Technologies, Inc.)
(Exact name of Registrant as specified in its charter)

CALIFORNIA	77-0223740
(State of incorporation)	(I.R.S. Employer Identification Number)

26632 TOWNE CENTER DRIVE
SUITE 320
FOOTHILL RANCH, CALIFORNIA 92610
(Address of principal executive officers)

(714) 649-5000
(Registrant's telephone number, including area code)

TITLE OF EACH CLASS	NAME OF EXCHANGE ON WHICH REGISTERED
Common Stock, no par value	Nasdaq National Market

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

Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated herein by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately $23,923,872 as of March 30, 2001, based upon the closing sale price reported for that date on the Nasdaq National Market. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

Indicate the number of shares outstanding of each of the issuer's classes of common stock outstanding as of the last practicable date.

31,696,061 shares
As of March 30, 2001

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PART I

ITEM 1. BUSINESS.

This Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties. The statements contained herein that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act, including without limitation statements regarding our expectations, beliefs, intentions or strategies regarding the future. All forward-looking statements included in this document or incorporated by reference herein are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth in Item 7 and elsewhere.

GENERAL

CardioGenesis Corporation formerly known as Eclipse Surgical Technologies, Inc., incorporated in California in 1989, designs, develops, manufactures and distributes laser-based surgical products and disposable fiber-optic accessories for the treatment of advanced cardiovascular disease through transmyocardial revascularization ("TMR") and percutaneous transluminal myocardial revascularization ("PMR"). TMR and PMR are recent laser-based heart treatments in which channels are made in the heart muscle. It is believed these procedures encourage new vessel formation, or angiogenesis. TMR is performed by a cardiac surgeon through a small incision in the chest under general anesthesia. PMR is performed by a cardiologist in a catheter based procedure which utilizes local anesthesia. Clinical studies have demonstrated a significant reduction in angina and increase in exercise duration in patients treated with TMR or PMR plus medications, when compared with patients who received medications alone.

We received CE Mark approval for our TMR system in May 1997 and our PMR systems in April 1998. On February 11, 1999, we received final approval from the FDA for our TMR products for treatment of stable patients with angina (Canadian Cardiovascular Society Class 4) refractory to other medical treatments and secondary to objectively demonstrated coronary artery atherosclerosis and with a region of the myocardium with reversible ischemia not amenable to direct coronary revascularization. Effective July 1, 1999, the Health Care Financial Administration began to provide Medicare coverage for TMR. Hospitals and physicians are now eligible to receive Medicare reimbursement for TMR equipment and procedures.

We have completed pivotal clinical trials involving PMR, and study results were submitted to the FDA in a Pre Market Approval application in December of 1999 along with subsequent amendments. As discussed below under the caption "Regulatory Status," the FDA Advisory Panel recommended against approval of PMR for public sale and use in the United States. However, we will continue to pursue FDA approval for PMR. There can be no assurance, however, that we will receive a favorable decision from that agency.

On March 17, 1999, we merged with the former CardioGenesis Corporation. Under the terms of the combination, each share of the former CardioGenesis common stock was converted into 0.8 of a share of our common stock, and the former CardioGenesis has become a wholly owned subsidiary of ours. As a result of the transaction, our outstanding shares increased by approximately 9.9 million shares. The transaction was structured to qualify as a tax-free reorganization and has been accounted for as a pooling of interests. Accordingly, the accompanying financial statements have been restated as if the combined entity existed for the 1998 period prior to the merger.

BACKGROUND

Cardiovascular disease is the leading cause of death and disability in the U.S. according to the American Heart Association. Coronary artery disease is the principal form of cardiovascular disease and is characterized by a progressive narrowing of the coronary arteries which supply blood to the heart. This narrowing process is usually due to atherosclerosis, which is the buildup of fatty deposits, or plaque, on the inner lining of the arteries.

Coronary artery disease reduces the available supply of oxygenated blood to the heart muscle, potentially resulting in severe chest pain known as angina, as well as damage to the heart. Typically, the condition worsens over time and often leads to heart attack and/or death.

Based on standards promulgated by the Canadian Heart Association, angina is typically classified into four classes, ranging from Class 1, in which angina pain results only from strenuous exertion, to the most severe class, Class 4, in which the patient is unable to conduct any physical activity without angina and angina may be present even at rest. The American Heart Association estimates that more than six million Americans experience angina symptoms.

The primary therapeutic options for treatment of coronary artery disease are drug therapy, balloon angioplasty also known as percutaneous transluminal coronary angioplasty or ("PTCA"), other interventional techniques which augment or replace PTCA such as stent placement and atherectomy, and coronary artery bypass grafting or ("CABG"). The objective of each of these approaches is to increase blood flow through the coronary arteries to the heart.

Drug therapy may be effective for mild cases of coronary artery disease and angina either through medical effects on the arteries that improve blood flow without reducing the plaque or by decreasing the rate of formation of additional plaque (e.g., by reducing blood levels of cholesterol). Because of the progressive nature of the disease, however, many patients with angina ultimately undergo either PTCA or CABG.

PTCA is a less-invasive alternative to CABG introduced in the early 1980s in which a balloon-tipped catheter is inserted into an artery, typically near the groin, and guided to the areas of blockage in the coronary arteries. The balloon is then inflated and deflated at each blockage site, thereby rupturing the blockage and stretching the vessel. Although the procedure is usually successful in widening the blocked channel, the artery often re-narrows within six months of the procedure, a process called "restenosis," often necessitating a repeat procedure. A variety of techniques for use in conjunction with PTCA have been developed in an attempt to reduce the frequency of restenosis, including stent placement and atherectomy. Stents are small metal frames delivered to the area of blockage using a balloon catheter and deployed or expanded within the coronary artery. The stent is a permanent implant intended to keep the channel open. Atherectomy is a means of using mechanical, laser or other techniques at the tip of a catheter to cut or grind away plaque.

CABG is an open chest procedure developed in the 1960s in which conduit vessels are taken from elsewhere in the body and grafted to the blocked coronary arteries so that blood can bypass the blockage. CABG typically requires the use of a heart-lung bypass machine to render the heart inactive (to allow the surgeon to operate on a still, relatively bloodless heart) and involves prolonged hospitalization and patient recovery periods. Accordingly, it is generally reserved for patients with severe cases of coronary artery disease or those who have previously failed to receive adequate relief of their symptoms from PTCA or related techniques. Most bypass grafts fail within one to fifteen years following the procedure. Repeating the surgery ("re-do bypass surgery") is possible, but is made more difficult because of scar tissue and adhesions that typically form as a result of the first operation. Moreover, for many patients CABG is inadvisable for various reasons, such as the severity of the patient's overall condition, the extent of coronary artery disease or the small size of the blocked arteries.

When these treatment options are exhausted, the patient is left with no viable surgical or interventional alternative other than, in limited cases, heart transplantation. Without a viable surgical alternative, the patient is generally managed with drug therapy, often with significant lifestyle limitations. TMR, which bears the CE Marking and has received FDA approval, and PMR, which bears the CE Marking and for which we are continuing to pursue FDA approval for use in the U.S., offer potential relief to a large population of patients with severe cardiovascular disease.

THE TMR AND PMR PROCEDURE

TMR, or transmyocardial revascularization, is a surgical procedure performed on the beating or non-beating heart, in which a laser device is used to create pathways through the myocardium directly into the heart

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chamber. The pathways are intended to supply blood to ischemic, or oxygen-deprived regions of the myocardium and reduce angina in the patient. TMR can be performed using open chest surgery or minimally invasive surgery through a small incision between the ribs. TMR offers end-stage cardiac patients who have regions of ischemia not amenable to PTCA or CABG a means to alleviate their symptoms and improve their quality of life. We have received FDA approval for U.S. commercial distribution of our TMR laser system for treatment of stable patients with angina (Canadian Cardiovascular Society Class 4) refractory to medical treatment and secondary to objectively demonstrated coronary artery atherosclerosis and with a region of the myocardium with reversible ischemia not amenable to direct coronary revascularization.

PMR, or percutaneous transluminal myocardial revascularization, is an interventional procedure performed by a cardiologist. PMR is based upon the same principles as TMR, but the procedure is much less invasive. The patient is under local anesthesia and is treated through a catheter inserted in the femoral artery at the top of the leg. A laser transmitting catheter is threaded up into the heart chamber, where channels are created in the inner portion of the myocardium (i.e. heart muscle). We have completed pivotal clinical trials involving PMR, and study results were submitted to the FDA in a Pre Market Approval application in December of 1999 along with subsequent amendments. As discussed below under the caption "Regulatory Status," the FDA Advisory Panel recommended against approval of PMR for public sale and use in the United States. However, we will continue to pursue FDA approval for PMR. There can be no assurance, however, that we will receive a favorable decision from that agency.

BUSINESS STRATEGY

Our objective is to become a recognized leader in the field of myocardial revascularization, with TMR and PMR established as well-known and acceptable therapies. Our strategies to achieve this goal are as follows:

- Expand Market for our Products. We are seeking to expand market awareness of our products among opinion leaders in the cardiovascular field, the referring physician community and the targeted patient population. In connection with the FDA approved TMR product, we have prioritized our initial efforts in the U.S. on the top 600 hospitals that perform the greatest number of cardiovascular procedures. To support the TMR launch, we are expanding the domestic sales force to thirty-one territory managers in four sales areas. We also sell our products in Europe and to the rest of the world through our direct international sales organization along with several distributors and agents. In addition, we have developed a comprehensive training program to assist physicians in acquiring the expertise necessary to utilize our TMR or PMR products and procedures.

- Demonstrate Clinical Utility of PMR. We are seeking to demonstrate the clinical safety and effectiveness of PMR. We have completed a pivotal clinical trial regarding PMR, and the study results were submitted to the FDA in a Pre Market Approval Supplemental application in December of 1999. As discussed below under the caption "Regulatory Status," the FDA Advisory Panel recommended against approval of PMR for public sale and use in the United States. However, we will continue to pursue FDA approval for PMR. There can be no assurance, however, that we will receive a favorable decision from the agency.

- Leverage Proprietary Technology. We believe that our significant expertise in laser and catheter-based systems for cardiovascular disease and the proprietary technologies we have developed are important factors in our efforts to demonstrate the safety and effectiveness of our TMR and PMR procedures. We are seeking to develop additional proprietary technologies for TMR, PMR and related procedures. We have 91 foreign and U.S. patents or allowed patent applications and 51 U.S. and 27 foreign patent applications pending relating to various aspects of TMR, PMR and other cardiovascular therapies.

PRODUCTS AND TECHNOLOGY

The Company's TMR System

The Company's TMR system consists of our TMR 2000 laser console and a line of fiber-optic, laser-based surgical tools. Each surgical tool utilizes an optical fiber assembly to deliver laser energy from the source laser base unit to the distal tip of the surgical handpiece or PMR catheter. The compact base unit occupies a small amount of operating room floor space, operates on a standard 208 or 220-volt power supply, and is light enough to move within the operating room or among operating rooms in order to use operating room space efficiently. Moreover, the flexible fiberoptic assembly used to deliver the laser energy to the patient enables ready access to the patient and to various sites within the heart.

Our TMR system and related surgical procedures are designed to be used without the requirement of the external systems utilized with certain competitive TMR systems. For example, our TMR 2000 system does not require electrocardiogram synchronization, which monitors the electrical output of the heart and times the use of the laser to minimize electrical disruption of the heart, or transesophageal echocardiography, which tests each application of the laser to the myocardium during the TMR procedure to determine if the pathway has penetrated through the myocardium into the heart chamber.

Our Holmium Laser. Our TMR 2000 laser base unit generates laser light of a 2-micron wavelength by photoelectric excitation of a solid state holmium crystal. The holmium laser, because it uses a solid state crystal as its source, is compact, reliable and requires minimal maintenance.

SoloGrip. The single use SoloGrip handpiece system contains multiple, fine fiber-optic strands in a one millimeter diameter bundle. The flexible fiber optic delivery system combined with the ergonomic handpiece provides access for treating all regions of the left ventricle.

The SoloGrip and SlimFlex PMR fiber-optic delivery systems each have an easy to install connector which screws into the laser base unit, and each device is pre-calibrated in the factory so it requires no special preparation.

The Company's PMR System

The Company's PMR System is currently sold only outside the United States. The PMR System consists of the PMR Laser and ECG Monitor.

Our PMR Laser. The holmium laser base unit generates laser light of a 2.1 micron wavelength in the mid-infrared spectrum. It provides a reliable source for laser energy with low maintenance.

The Axcis Catheter system. The Axcis catheter system is an over-the-wire system that consists of two components, the Axcis laser catheter and Axcis aligning catheter. The Axcis catheter system is designed to provide controlled navigation and access to target regions of the left ventricle. The coaxial Axcis laser catheter has an independent, extendible lens with radiopaque lens markers which show the location and orientation of the tip for optimal contact with the ventricle wall. The Axcis laser catheter also has nitinol petals at the laser-lens tip which are designed for safe penetration of the endocardium and to provide depth control.

SlimFlex Catheter System. The SlimFlex PMR system is an over-the-wire, steerable, single use catheter system that features torque control, deflection capability, infusion port and radio-opaque markers for enhanced visualization and depth control. After insertion into an artery of the leg, the PMR catheter is advanced over the aortic arch, across the aortic valve and into the heart chamber. Visualization is achieved using standard fluoroscopic or x-ray techniques common to all hospitals doing cardiac catheterization.

REGULATORY STATUS

On February 11, 1999, we received final approval from the FDA for use of our TMR 2000 laser console and SoloGrip handpiece for treatment of stable patients with angina (Canadian Cardiovascular Society Class 4) refractory to other medical treatments and secondary to objectively demonstrated coronary artery atherosclerosis and with a region of the myocardium with reversible ischemia not amenable to direct coronary revascularization.

In February 1996, we obtained FDA clearance to undertake Phase I of a clinical study of TMR intended to assess the safety and effectiveness of "TMR Used in Conjunction with CABG" as compared with CABG alone. In September 1996, the FDA provided us with clearance to begin Phase II of this study, which was subsequently completed. In July 1999, we submitted a PMA supplement to the FDA for an expanded indication to our approved TMR labeling to include TMR in conjunction with CABG. In January 2000, we received a response from the FDA requesting that we either provide more information or modify our labeling request. Since TMR and CABG are each presently utilized to treat separate regions of the heart, we concluded that our present FDA approved labeling is adequate, and that the physician can best decide how to use the laser system within the approved labeling. As a result, in March 2000, we decided that we will not pursue any wording changes to our already approved TMR labeling, and have withdrawn our submission to the FDA for TMR in conjunction with CABG.

We submitted a PMA supplement for our PMR system to the FDA in December 1999. The PMR study compares PMR to conventional medical therapy in patients with no option for other treatment. As discussed below, the FDA Advisory Panel recommended against approval of PMR for public sale and use in the United States. However, we will continue to pursue FDA approval for PMR. There can be no assurance, however, that we will receive a favorable decision from the agency.

We have decided not to pursue any additional claims for adjunctive procedures. Therefore, all studies involving adjunctive procedures have been halted and terminated.

In addition, we have obtained approval to affix the CE Marking to substantially all of our products, which enables us to commercially distribute our TMR and PMR products throughout the European Community.

On July 9, 2001, the Food and Drug Administration Advisory Panel recommended against approval by the Food and Drug Administration of our PMR device for public sale and use in the United States. The practical effect of the Advisory Panel's recommendation is to delay indefinitely, until such time as the Food and Drug Administration decides differently, the introduction of our PMR device for sale and use in the United States. Consequently, the Advisory Panel's recommendation has effectively delayed potential revenue, if any, that may have been derived in the future from the sale of our PMR device. Moreover, this recommendation has necessitated the further investment of additional resources toward obtaining the Food and Drug Administration's approval of our PMR device. However, we do not expect to conduct further clinical trials. Additionally, the trading price of our common stock on the NASDAQ National Market fell substantially after the Advisory Panel's recommendation became public. As discussed in our risk factor section, if our common stock were to trade under $1.00 for 30 consecutive days on the NASDAQ National Market, our common stock could be subject to certain consequences established by the NASDAQ National Market, such as being delisted.

SALES AND MARKETING

We have received FDA approval for our surgical TMR laser system. The Health Care Finance Administration has also announced its coverage policy for the TMR with FDA approved systems. We are promoting market awareness of our approved surgical products among opinion leaders in the cardiovascular field and are recruiting physicians and hospitals. To drive the clinical awareness and acceptance of the surgical product platform, we are expanding the domestic sales force to thirty-one territory managers in four sales regions.

In the United States, we currently offer a laser base unit at a current end user list price of $320,000 per unit, and the disposable TMR handpiece (at least one of which must be used with each TMR procedure) at an end user unit list price of $2,745. In order to accelerate market adoption of the TMR procedure, we intend to continue selling lasers to hospitals outright, loaning lasers to hospitals in return for the hospital purchasing a minimum number of handpieces at a premium over the list price, and to begin renting lasers to hospitals.

Internationally, we sell our products through a direct sales and support organization of four people and distributors and agents.

We have developed, in conjunction with several major hospitals using our TMR or PMR products, a training program to assist physicians in acquiring the expertise necessary to utilize our products and procedures. This program includes a comprehensive one-day course including didactic training and hands-on performance of TMR or PMR in vivo. To date over 750 cardiothoracic surgeons have been trained on the CardioGenesis TMR system.

We exhibit our products at major cardiovascular meetings. Investigators of our products have made presentations at meetings around the world, describing their results. Abstracts and articles have been published in peer-reviewed publications and industry journals to present the results of our clinical trials.

RESEARCH AND DEVELOPMENT

We believe that streamlining our research and product effort is essential to our ability to stimulate growth and maintain our market leadership position. Our ongoing research and product development efforts are focused on the development of new and enhanced lasers and fiber-optic handpieces for TMR and PMR applications.

In the fourth quarter of 2000, we increased our ownership interest in privately-held Microheart Holdings, Inc. to 32.1 percent. Microheart is a research and development company working on developing a number of full-featured clinical devices for diagnostic assessment and site-specific delivery of biopharmaceuticals and other therapeutic agents applicable to the cardiovascular and other markets.

We believe our future success will depend, in part, upon the success of our research and development programs. There can be no assurance that we will realize financial benefit from these efforts or that products or technologies developed by others will not render our products or technologies obsolete or non-competitive.

MANUFACTURING

We manufacture and assemble our products from purchased components and subassemblies at our facility in Sunnyvale, California.

The core components of our laser units and fiber-optic handpieces are generally acquired from multiple sources. We currently purchase certain laser and fiber-optic components and subassemblies from single sources. Although we have identified alternative vendors, the qualification of additional or replacement vendors for certain components or services is a lengthy process. Any significant supply interruption would have a material adverse effect on our ability to manufacture our products and, therefore, would harm our business. We intend to continue to qualify multiple sources for components that are presently single sourced and also to maintain an inventory of these items for use in the event of supply interruptions.

COMPETITION

We expect that the market for TMR and PMR, which is currently in the early stages of development, will be competitive. At this point in time, we believe that our only competitor is PLC Systems, Inc. ("PLC") which is selling FDA-approved TMR products in the U.S. and abroad. Other competitors may also enter the market, including large companies in the laser and cardiac surgery markets. Many of these companies have or may have significantly greater financial, research and development, marketing and other resources than we do.

PLC is a publicly traded corporation which uses a CO2 laser and an articulated mechanical arm in its TMR products. PLC obtained a Pre Market Approval for TMR in 1998. PLC has received the CE Marking, which allows sales of its products commercially in all European Union countries. PLC has been issued patents for its apparatus and methods for TMR. PLC recently announced a co-marketing agreement with Edwards Life Sciences to distribute their lasers and disposables. This action will add another 18 direct domestic sales representatives involved in promoting the PLC technology.

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We believe that the factors which will be critical to market success include: the timing of receipt of requisite regulatory approvals, effectiveness and ease of use of the TMR products and applications, breadth of product line, system reliability, brand name recognition and effectiveness of distribution channels and cost of capital equipment and disposable devices.

TMR and PMR also compete with other methods for the treatment of cardiovascular disease, including drug therapy, PTCA and CABG. Even with the FDA approval of our TMR system in patients for whom other cardiovascular treatments are not likely to provide relief, and when used in conjunction with other treatments, we can not assure you that our TMR or PMR products will be accepted. Moreover, technological advances in other therapies for cardiovascular disease such as pharmaceuticals or future innovations in cardiac surgery techniques could make such other therapies more effective or lower in cost than our TMR procedure and could render our technology obsolete. We can not assure you that physicians will use our TMR procedure to replace or supplement established treatments, or that our TMR procedure will be competitive with current or future technologies. Such competition could harm our business.

Our TMR laser system and any other product developed by us that gains regulatory approval will face competition for market acceptance and market share. An important factor in such competition may be the timing of market introduction of competitive products. Accordingly, the relative pace at which we can develop products, complete clinical testing, achieve regulatory approval, gain reimbursement acceptance and supply commercial quantities of the product to the market are expected to be important competitive factors. In the event a competitor is able to obtain a PMA for its products prior to our doing so, we may not be able to compete successfully. We may not be able to compete successfully against current and future competitors even if we obtain a PMA prior to our competitors.

GOVERNMENT REGULATION

Laser-based surgical products and disposable fiber-optic accessories for the treatment of advanced cardiovascular disease through TMR are considered medical devices, and as such are subject to regulation in the U.S. by the FDA and comparable international regulatory agencies. Our devices require the rigorous PMA process for approval to market the product in the U.S. and must bear the CE Marketing for commercial distribution in the European Community.

To obtain a Pre Market Approval ("PMA") for a medical device, we must file a PMA application that includes clinical data and the results of pre-clinical and other testing sufficient to show that there is a reasonable assurance of safety and effectiveness of the product for its intended use. To begin a clinical study, an Investigational Device Exemption ("IDE") must be obtained and the study must be conducted in accordance with FDA regulations. An IDE application must contain preclinical test data demonstrating the safety of the product for human investigational use, information on manufacturing processes and procedures, and proposed clinical protocols. If the FDA clears the IDE application, human clinical trials may begin. The results obtained from these trials are accumulated and, if satisfactory, are submitted to the FDA in support of a PMA application. Prior to U.S. commercial distribution, premarket approval is required from the FDA. In addition to the results of clinical trials, the PMA application must include other information relevant to the safety and effectiveness of the device, a description of the facilities and controls used in the manufacturing of the device, and proposed labeling. By law, the FDA has 180 days to review a PMA application. While the FDA has responded to PMA applications within the allotted time frame, reviews more often occur over a significantly longer period and may include requests for additional information or extensive additional trials. There can be no assurance that we will not be required to conduct additional trials which may result in substantial costs and delays, nor can there be any assurance that a PMA will be obtained for each product in a timely manner, if at all. In addition, changes in existing regulations or the adoption of new regulations or policies could prevent or delay regulatory approval of our products. Furthermore, even if a PMA is granted, subsequent modifications of the approved device or the manufacturing process may require a supplemental PMA or the submission of a new PMA which could require substantial additional clinical efficacy data and FDA review. After the FDA accepts a PMA application for filing, and after FDA review of the application, a public meeting is frequently held before an FDA advisory panel in which the PMA is reviewed and discussed. The panel then issues a favorable or unfavorable recommendation to the FDA or

recommends approval with conditions. Although the FDA is not bound by the panel's recommendations, it tends to give such recommendations significant weight. In February 1999, we received a PMA for our TMR laser system for use in certain indications. As discussed above under the caption "Regulatory Status," the FDA Advisory Panel recommended against approval of PMR for public sale and use in the United States. However, we will continue to pursue FDA approval for PMR. There can be no assurance, however, that we will receive a favorable decision from that agency.

Products manufactured or distributed by us pursuant to a PMA will be subject to pervasive and continuing regulation by the FDA, including, among other things, postmarket surveillance and adverse event reporting requirements. Failure to comply with applicable regulatory requirements can result in, among other things, warning letters, fines, suspensions or delays of approvals, seizures or recalls of products, operating restrictions or criminal prosecutions. The Federal Food, Drug and Cosmetic Act requires us to manufacture our products in registered establishments and in accordance with Good Manufacturing Practices ("GMP") regulations and to list our devices with the FDA. Furthermore, as a condition to receipt of a PMA, our facilities, procedures and practices will be subject to additional pre-approval GMP inspections and thereafter to ongoing, periodic GMP inspections by the FDA. These GMP regulations impose certain procedural and documentation requirements upon us with respect to manufacturing and quality assurance activities. Labeling and promotional activities are subject to scrutiny by the FDA. Current FDA enforcement policy prohibits the marketing of approved medical devices for unapproved uses. Changes in existing regulatory requirements or adoption of new requirements could harm our business. We may be required to incur significant costs to comply with laws and regulations in the future and current or future laws and regulations may harm our business.

We are also regulated by the FDA under the Radiation Control for Health and Safety Act, which requires laser products to comply with performance standards, including design and operation requirements, and manufacturers to certify in product labeling and in reports to the FDA that our products comply with all such standards. The law also requires laser manufacturers to file new product and annual reports, maintain manufacturing, testing and sales records, and report product defects. Various warning labels must be affixed and certain protective devices installed, depending on the class of the product. In addition, we are subject to California regulations governing the manufacture of medical devices, including an annual licensing requirement. Our facilities are subject to ongoing, periodic inspections by the FDA and California regulatory authorities.

Sales, manufacturing and further development of our TMR and PMR systems also may be subject to additional federal regulations pertaining to export controls and environmental and worker protection, as well as to state and local health, safety and other regulations that vary by locality and which may require obtaining additional permits. We can not predict the impact of these regulations on our business.

Sales of medical devices outside of the U.S. are subject to foreign regulatory requirements that vary widely by country. In addition, the FDA must approve the export of devices to certain countries. To market in Europe, a manufacturer must obtain the certifications necessary to affix to its products the CE Marking. The CE Marking is an international symbol of adherence to quality assurance standards and compliance with applicable European medical device directives. In order to obtain and to maintain a CE Marking, a manufacturer must be in compliance with appropriate ISO 9001 standards and obtain certification of its quality assurance systems by a recognized European Union notified body. However, certain individual countries within Europe require further approval by their national regulatory agencies. We have achieved International Standards Organization and European Union certification for our manufacturing facility. In addition, we have completed CE mark registration for all of our products in accordance with the implementation of various medical device directives in the European Union. Failure to maintain the right to affix the CE Marking or other requisite approvals could prohibit us from selling our TMR products in member countries of the European Union or elsewhere.

INTELLECTUAL PROPERTY MATTERS

Our success will depend, in part, on our ability to obtain patent protection for our products, preserve our trade secrets, and operate without infringing the proprietary rights of others. Our policy is to seek to protect our proprietary position by, among other methods, filing U.S. and foreign patent applications related to our technology, inventions and improvements that are important to the development of our business. We have 91 U.S.

and foreign patents or allowed patent applications and 78 U.S. and foreign patent applications pending relating to various aspects of TMR, PMR and other cardiovascular therapies. On December 5, 2000 we were granted United States Patent No. 6,156,031 entitled "Transmyocardial Revascularization Using Radiofrequency Energy". Our patents or patent applications may be challenged, invalidated or circumvented in the future or the rights granted may not provide a competitive advantage. We intend to vigorously protect and defend our intellectual property. We do not know if patent protection will continue to be available for surgical methods in the future. Costly and time-consuming litigation brought by us may be necessary to enforce our patents and to protect our trade secrets and know-how, or to determine the enforceability, scope and validity of the proprietary rights of others.

We also rely upon trade secrets, technical know-how and continuing technological innovation to develop and maintain our competitive position. We typically require our employees, consultants and advisors to execute confidentiality and assignment of inventions agreements in connection with their employment, consulting, or advisory relationships with us. These agreements may be breached or we may not have adequate remedies for any breach. Furthermore, our competitors may independently develop substantially equivalent proprietary information and techniques or otherwise gain access to our proprietary technology, or we may not be able to meaningfully protect our rights in unpatented proprietary technology.

The medical device industry in general, and the industry segment that includes products for the treatment of cardiovascular disease in particular, have been characterized by substantial competition and litigation regarding patent and other intellectual property rights. In this regard, our competitors have been issued a number of patents related to TMR and PMR. In September 1995 we received from a competitor a notice of potential infringement of the competitor's patent regarding a method for TMR utilizing synchronization of laser pulses to the electrical signals from the heart. We concluded, following discussion with our patent counsel, that we did not utilize the process and/or apparatus which is the subject of the patent at issue. We responded to the competitor to such effect and have received no further correspondence on this matter. There can be no assurance, however, that further claims or proceedings will not be initiated by a competitor, or that claims by other parties will not arise in the future. Any such claims in the future, with or without merit, could be time-consuming and expensive to respond to and could divert the attention of our technical and management personnel. We may be involved in litigation to defend against claims of our infringement, to enforce our patents, or to protect our trade secrets. If any relevant claims of third party patents are upheld as valid and enforceable in any litigation or administrative proceeding, we could be prevented from practicing the subject matter claimed in such patents, or we could be required to obtain licenses from the patent owners of each such patent or to redesign our products or processes to avoid infringement.

Until recently, patent applications in the U.S. were maintained in secrecy until patents issue, and patent applications in foreign countries are maintained in secrecy for a period after filing. Most of our U.S. applications are maintained in secrecy unless they have issued. Publication of discoveries in the scientific or patent literature tends to lag behind actual discoveries and the filing of related patent applications. Accordingly, we can not assure you our current and potential competitors and other third parties have not filed or in the future will not file applications for, or have not received or in the future will not receive, patents or obtain additional proprietary rights that will prevent, limit or interfere with our ability to make, use or sell our products either in the U.S. or internationally. In the event we were to require licenses to patents issued to third parties, such licenses may not be available or, if available, may not be available on terms acceptable to us. In addition, we may not be successful in any attempt to redesign our products or processes to avoid infringement or that any such redesign could be accomplished in a cost-effective manner. Accordingly, an adverse determination in a judicial or administrative proceeding or failure to obtain necessary licenses could prevent us from manufacturing and selling our products, which would harm our business.

Unrelated to the products used in our TMR procedure, we have received notices from three holders of patents requesting we become a licensee. Although we believe that either these patents are subject to challenge as being invalid or are not infringed by our products, we may not prevail in any such action. In one case, we have entered into a non-exclusive license to a patent involving arthroscopy use. In a second case, we buy components only from licensees of the patent holder, which we believe obviates the need for a separate license. If we determine that it is necessary to obtain a license to any patents or intellectual property, any such license may not

be available on acceptable terms or at all, or we may not be able to develop or otherwise obtain alternative technology. Failure to obtain necessary licenses could prevent us from manufacturing and selling our products, which would harm our business.

THIRD PARTY REIMBURSEMENT

We expect that sales volumes and prices of our products will depend significantly on the availability of reimbursement for surgical procedures using our products from third party payors such as governmental programs, private insurance and private health plans. Reimbursement is a significant factor considered by hospitals in determining whether to acquire new equipment. Reimbursement rates from third party payors vary depending on the third party payor, the procedure performed and other factors. Moreover, third party payors, including government programs, private insurance and private health plans, have in recent years been instituting increasing cost containment measures designed to limit payments made to healthcare providers by, among other measures, reducing reimbursement rates, limiting services covered, negotiating prospective or discounted contract pricing and carefully reviewing and increasingly challenging the prices charged for medical products and services.

Medicare reimburses hospitals on a prospectively determined fixed amount for the costs associated with an in-patient hospitalization based on the patient's discharge diagnosis, and reimburses physicians on a prospectively determined fixed amount based on the procedure performed, regardless of the actual costs incurred by the hospital or physician in furnishing the care and unrelated to the specific devices used in that procedure. Medicare and other third party payors are increasingly scrutinizing whether to cover new products and the level of reimbursement for covered products. In addition, Medicare traditionally has considered items or services involving devices that have not been approved or cleared for marketing by the FDA to be precluded from Medicare coverage. In July 1999 HCFA began coverage of FDA approved TMR systems for any manufacturer's TMR procedures.

We have limited experience to date with the acceptability of our TMR procedures for reimbursement by private insurance and private health plans. Private insurance and private health plans may not approve reimbursement for TMR or PMR. The lack of private insurance and health plans reimbursement may harm our business.

In foreign markets, reimbursement is obtained from a variety of sources, including governmental authorities, private health insurance plans and labor unions. In most foreign countries, there are also private insurance systems that may offer payments for alternative therapies. Although not as prevalent as in the U.S., health maintenance organizations are emerging in certain European countries. We may need to seek international reimbursement approvals, and we may not be able to attain these approvals in a timely manner, if at all. Failure to receive foreign reimbursement approvals could make market acceptance of our products in the foreign markets in which such approvals are sought more difficult.

We believe that reimbursement in the future will be subject to increased restrictions such as those described above, both in the U.S. and in foreign markets. We also believe that the escalating cost of medical products and services has led to and will continue to lead to increased pressures on the health care industry, both foreign and domestic, to reduce the cost of products and services, including products offered by us. Third party reimbursement and coverage may not be available or adequate in U.S. or foreign markets, current levels of reimbursement may be decreased in the future or future legislation, regulation, or reimbursement policies of third party payors may reduce the demand for our products or our ability to sell our products on a profitable basis. Fundamental reforms in the healthcare industry in the U.S. and Europe that could affect the availability of third party reimbursement continue to be proposed, and we cannot predict the timing or effect of any such proposal. If third party payor coverage or reimbursement is unavailable or inadequate, our business may suffer.

PRODUCT LIABILITY AND INSURANCE

We maintain insurance against product liability claims in the amount of $10 million per occurrence and $10 million in the aggregate. We may not be able to obtain additional coverage or continue coverage in the

amount desired or on terms acceptable to us, and such coverage may not be adequate for liabilities actually incurred. Any uninsured or underinsured claim brought against us or any claim or product recall that results in a significant cost to or adverse publicity against us could harm our business.

EMPLOYEES

As of December 31, 2000 we had 123 employees, including 16 in research and development, 49 in manufacturing, 38 in sales and marketing and 20 in administration. Other than confidentiality agreements with all employees, as a general policy matter, we do not enter into employment agreements with any of our employees. In connection with the recent hiring of Michael J. Quinn as our

Chief Executive Officer and Darrell Eckstein as our Vice President of Operations, we did, however, provide both officers with letter employment agreements. None of our employees is covered by a collective bargaining agreement and we have not experienced any work stoppages to date.

Our executive officers as of March 28, 2001 are as follows:

NAME	AGE	POSITION
Michael J. Quinn	56	Chief Executive Officer, President, Chairman of the Board and Director
Darrell F. Eckstein	43	Vice President of Operations
Ian A. Johnston	46	Vice President of Finance and Treasurer
Thomas L. Kinder	38	Vice President of Worldwide Sales and Service
Richard P. Lanigan	42	Vice President of Government Affairs and Business Development
Christopher M. Owens	32	Vice President of Marketing
Ilene L. Janofsky	46	Chief Legal Counsel

Michael J. Quinn has served as our Chief Executive Officer, President and Chairman of the Board since October 2000. From November 1999 to September 2000, Mr. Quinn served as Chief Executive Officer, President and a member of the Board of Directors for Premier Laser Systems, a manufacturer of surgical and dental products. From January 1998 to November 1999, Mr. Quinn served as President and Chief Operating Officer of Imagyn Medical Technologies, Inc., a manufacturer of minimally invasive surgical specialty products. From 1995 through December 1997, Mr. Quinn served as President and Chief Operating Officer of Fisher Scientific Company. Prior to 1995, Mr. Quinn held senior operating management positions at major healthcare organizations including American Hospital Supply Corporation, Picker International, Cardinal Health Group and Bergen Brunswig.

Darrell F. Eckstein has served as our Vice President of Operations since December 2000. From 1996 to 2000 he served as Vice President and General Manager of the Surgical Products Division of Imagyn Medical Technologies, a manufacturer of minimally invasive surgical specialty products. From 1995 to 1996, Mr. Eckstein was Vice President of Finance, Chief Financial Officer and an Executive Committee member of Richard-Allen Medical Industries Inc., a medical devices company. From 1991 to 1995, Mr. Eckstein was Vice President of Finance, Chief Financial Officer and an Executive Committee member of National Emergency Services Inc., a health care services company that provides physician contract management, medical billing and insurance services. Prior to 1991, Mr. Eckstein worked for Deloitte and Touche, most recently as a Senior Audit Manager, for 11 years. He received his Bachelor of Science degree in Accounting from Indiana University.

Ian A. Johnston has been our Vice President of Finance since July 2000 and Corporate Controller since March 1999. From 1998 to 1999 Mr. Johnston was also Controller of the former CardioGenesis Corporation. From 1989 to 1998 Mr. Johnston served in a variety of financial positions (most recently as Controller) at Toshiba America MRI, Inc., a medical imaging company. From 1985 to 1989 Mr. Johnston was an auditor with Arthur Andersen & Co. Mr. Johnston has a Masters in Business Administration and a Bachelor of Arts in Economics from the University of California Berkeley and is a member of the American Institute of Certified Public Accountants.

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Thomas L. Kinder has served as our Vice President of Sales since March 2001 and as General Manager, West Area since November 2000. From June 2000 to November 2000, Mr. Kinder served as Vice President of Sales for Watchitwork.com. From September 1999 to November 2000, Mr. Kinder served as General Manager for Karl Storz Endoscopy. From March 1996 to September 1999, Mr. Kinder served in the roles of Business Director, Area Vice-President and, most recently, Vice President of Sales for Imagyn Medical Technologies, Inc. From March 1996 to April 1997, Mr. Kinder served as Director of Sales for Microsurg, a company that was later sold to Imagyn Medical Technologies, Inc.

Richard P. Lanigan has been our Vice President of Government Affairs and Business Development since March 2001, Vice President of Sales and Marketing since March 2000 and Director of Marketing since 1997. From 1992 to 1997, Mr. Lanigan served in various positions, most recently Marketing Manager, at Stryker Endoscopy. From 1987 to 1992, Mr. Lanigan served in Manufacturing and Operations management at Raychem Corporation. From 1981 to 1987, he served in the U.S. Navy where he completed six years of service as Lieutenant in the Supply Corps. Mr. Lanigan has a Bachelors of Arts in Finance from Notre Dame and a Masters degree in Systems Management from the University of Southern California.

Christopher M. Owens has been our Vice President of Marketing since March 2001. Prior to CardioGenesis, Mr. Owens was Director of Marketing for the global Lamellar Surgery business of Bausch & Lomb. The Lamellar Surgery business provides surgical products for vision correction procedures. From 1997 to 2000, Mr. Owens served in a variety of sales related positions (most recently National Sales Manager) at Imagyn Medical Technologies, Inc., a manufacturer of minimally invasive surgical specialty products. From 1996 to 1997, Mr. Owens was Marketing Product Manager for Stackhouse, Inc From 1990 to 1996 he also served as a Product Development Engineer at Baxter Healthcare Corp. He has both a Bachelors and Masters degree in Plastics Engineering from the University of Massachusetts and a Masters in Business Administration from the University of Phoenix.

Ilene L. Janofsky has served as our Chief Legal Counsel since January 2001. From 1999 to 2000 Ms. Janofsky served as Patent Manager, Intellectual Property Counsel and from June 1998 to March 1999 she served as Patent Counsel. >From 1993 to 1998 Ms. Janofsky worked as an independent patent law consultant. >From 1990 to 1993 Ms. Janofsky was employed as a Patent Attorney with the Liposome Company. She has also worked as a Patent Attorney on an independent basis from 1988 to 1989 and with the New York city law firm of Ladas & Parry from 1987 to 1988. Ms. Janofsky is admitted to practice law in New York (1986), New Jersey (1986) and before the United States Patent and Trademark Office (1983). She passed the California Bar exam in July 2000 and is awaiting admission. Ms. Janofsky received her Bachelor of Science in Clinical Nutrition from the University of Florida, Gainesville in 1976 and her Juris Doctorate from St. John's University Law School in 1985.

ITEM 2. DESCRIPTION OF PROPERTY.

Our headquarters, located in Foothill Ranch, California, are comprised of 17,845 square feet of leased space. The lease expires in July 2006. Our facilities, located in Sunnyvale, California, are comprised of 45,960 square feet. The manufacturing facility contains a Class 10,000 clean room for laser handpiece and catheter fabrication. The Sunnyvale, California leases expire from July 2002 through September 2002. We believe our facilities are adequate to meet our foreseeable requirements. There can be no assurance that additional facilities will be available to us, if and when needed, thereafter.

ITEM 3. LEGAL PROCEEDINGS.

There are no pending legal proceedings against us other than ordinary litigation incidental to our business, the outcome of which, individually or in the aggregate, is not expected to have a material adverse effect on our business or financial condition.

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

None.

PART II

ITEM 5. MARKET FOR REGISTRANTS SHARES AND RELATED SHAREHOLDER MATTERS.

(a) Our common stock is traded on the Nasdaq National Market under the symbol CGCP (and, prior to our name change, under the symbol ESTI), since May 31, 1996. For the periods indicated, the following table presents the range of high and low sale prices for the common stock as reported by the Nasdaq National Market.

2000	HIGH	LOW
First Quarter	$11.50	$6.75
Second Quarter	$ 7.69	$2.88
Third Quarter	$ 4.69	$3.31
Fourth Quarter	$ 4.06	$0.50

1999	HIGH	LOW
First Quarter	$14.25	$7.25
Second Quarter	$12.38	$7.69
Third Quarter	$18.69	$9.75
Fourth Quarter	$15.94	$5.00

As of December 31, 2000 shares of our common stock were held by 190 shareholders of record.

We have never paid a cash dividend on our common stock and do not anticipate paying any cash dividends in the foreseeable future, as we intend to retain our earnings, if any, to generate increased growth and for general corporate purposes.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA.

The following selected consolidated statement of operations data for fiscal years ended 2000, 1999 and 1998 and the consolidated balance sheet data for 2000 and 1999 set forth below are derived from the our consolidated financial statements and are qualified by reference to our consolidated financial statements included herein.

The selected consolidated statement of operations data for fiscal year ended 1997 and 1996 and the consolidated balance sheet data for 1998, 1997 and 1996 have been derived from our audited financial statements not included herein. These historical results are not necessarily indicative of the results of operations to be expected for any future period. As a result of our pooling of interest with the former CardioGenesis, all prior period data has been restated as if the combined entity existed for all periods presented.

SELECTED CONSOLIDATED FINANCIAL DATA
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	YEAR ENDED DECEMBER 31,				
	2000	1999(1)	1998	1997	1996
STATEMENT OF OPERATIONS DATA:					
Net revenues........................	$ 22,210	$ 25,324	$ 15,080	$ 13,058	$ 13,718
Cost of revenues....................	10,055	13,246	7,868	7,295	6,424
Gross profit........................	12,155	12,078	7,212	5,763	7,294
Operating expenses:					
Research and development............	5,065	11,353	29,861	26,217	13,323
Sales and marketing.................	15,349	16,553	17,663	11,542	5,949
General and administrative..........	6,660	8,028	10,821	9,462	4,820
Merger-related costs................	--	5,214	--	--	--
Total operating expenses............	27,074	41,148	58,345	47,221	24,092
Operating loss......................	(14,919)	(29,070)	(51,133)	(41,458)	(16,798)
Interest and other income (expense), net................................	310	737	3,366	5,240	3,842
Net loss............................	$(14,609)	$(28,333)	$(47,767)	$(36,218)	$(12,956)
Net loss per share -- basic and diluted..........................	$ (0.48)	$ (0.99)	$ (1.77)	$ (1.39)	$ (0.65)
Shares used in per share calculation	30,166	28,629	27,000	26,027	20,019
BALANCE SHEET DATA:					
Cash, cash equivalents and marketable securities........................	$ 3,357	$ 13,313	$ 27,941	$ 75,729	$110,271
Working capital.....................	4,662	10,031	22,243	68,999	105,185
Total assets........................	16,965	34,019	52,978	91,714	123,003
Long-term debt, less current portion.	405	815	114	10	20
Accumulated deficit.................	(153,833)	(139,224)	(110,891)	(63,124)	(26,906)
Total shareholders' equity..........	7,974	18,573	37,276	82,374	117,061

(1) Cost of revenues includes $2.5 million of inventory write-offs and upgrades associated with the March 1999 merger.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains descriptions of our expectations regarding future trends affecting our business. These forward-looking statements and other forward-looking statements made elsewhere in this document are made in reliance upon the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Please read the section below titled "Factors Affecting Future Results" to review conditions which we believe could cause actual results to differ materially from those contemplated by the forward-looking statements. Forward-looking statements are identified by words such as "believes," "anticipates," "expects," "intends," "plans," "will," "may" and similar expressions. In addition, any statements that refer to our plans, expectations, strategies or other characterizations of future events or circumstances are forward-looking statements. Our business may have changed since the date hereof and we undertake no obligation to update these forward looking statements.

The following discussion should be read in conjunction with financial statements and notes thereto included in this Annual Report on Form 10-K.

OVERVIEW

CardioGenesis Corporation formerly known as Eclipse Surgical Technologies, Inc. ("CardioGenesis", "Company"), incorporated in California in 1989, designs, develops, manufactures and distributes laser-based surgical products and disposable fiber-optic accessories for the treatment of advanced cardiovascular disease through transmyocardial revascularization ("TMR") and percutaneous transluminal myocardial revascularization ("PMR").

On February 11, 1999, we received final approval from the FDA for our TMR products for certain indications, and we are now able to sell those products in the U.S. on a commercial basis. We have also received the European Conforming Mark ("CE Mark") allowing the commercial sale of our TMR laser systems and our PMR catheter system to customers in the European Community. Effective July 1, 1999, Health Care Financial Administration began providing Medicare coverage for TMR. Hospitals and physicians are now eligible to receive Medicare reimbursement for TMR equipment and procedures.

We have completed pivotal clinical trials involving PMR, and study results were submitted to the FDA in a Pre Market Approval (PMA) application in December of 1999 along with subsequent amendments. As discussed above under the caption "Regulatory Status," the FDA Advisory Panel recommended against approval of PMR for public sale and use in the United States. However, we will continue to pursue FDA approval for PMR. There can be no assurance, however, that we will receive a favorable decision from the agency.

As of December 31, 2000, we had an accumulated deficit of $153,833,000. We expect to continue to incur operating losses related to the expansion of sales and marketing activities. The timing and amounts of our expenditures will depend upon a number of factors, including the efforts required to develop our sales and marketing organization, the timing of market acceptance, if any, of our products and the status and timing of regulatory approvals.

RESULTS OF OPERATIONS

YEAR ENDED DECEMBER 31, 2000 COMPARED TO YEAR ENDED DECEMBER 31, 1999

Net Revenues

Net revenues of $22,210,000 for the year ended December 31, 2000 decreased $3,114,000 or 12% when compared to net revenues of $25,324,000 for the year ended December 31, 1999. The decrease in revenue was mainly due to a reduction in sales of laser systems resulting from a change, made at the end of 1999, to a new

sales model which emphasizes laser system placements to develop the disposable handpiece market more rapidly. The reduction in laser sales is partially offset by an increase in disposable handpiece sales generated from the new sales model.

Laser revenue fell by $8,750,000 while disposable handpieces revenue increased by $8,000,000. Handpiece revenue consisted of $3,100,000 in sales of product to customers operating under the loaned laser program, $2,000,000 in premiums associated with those handpieces and $7,300,000 in handpiece sales to customers not operating under the loaned laser program. Compared to the prior year, these handpiece sales increased $2,600,000, $1,900,000 and $3,500,000, respectively. Other domestic changes in revenue in the year ended December 31, 2000 were reductions due to no research revenue associated with the sale of intellectual property compared to $730,000 in the prior year, no domestic PMR revenue for product sold in conjunction with active clinical trials as compared to $600,000 in the year prior and a $300,000 increase in service revenue associated with extended service contracts and service calls. International sales, accounting for approximately 10% of total sales for the year ended December 31, 2000, fell $1,300,000 from the prior year when international sales accounted for 14% of total sales. This reduction can be explained by a reduction in international sales representation. We define international sales as sales to customers located outside of the United States. (See "-- Risk Factors.")

Gross Profit

Gross profit increased to $12,155,000 or 55% of net revenues for the year ended December 31, 2000 as compared to $12,078,000 or 48% of net revenues for the year ended December 31, 1999. In 1999 we incurred $2,523,000 in cost of revenues for inventory write-offs and a laser upgrade program resulting from our merger with the former CardioGenesis Corporation. Excluding these one-time charges, gross margin in the year ended December 31, 2000 decreased $2,446,000 compared to the prior year. This decrease in gross margin in absolute terms and as a percentage of sales resulted from the fixed component of cost of goods sold becoming a larger portion of sales, due to the decrease in sales volumes.

We began using a new sales model in the quarter ending December 31, 1999. The new sales model was derived to expedite the process of laser system placement and the adoption of TMR. Under the new model, hospitals were given the opportunity to bypass the capital approval process and, as a result, we were able to place more lasers than we would have placed if we had continued to sell lasers to hospitals. Given that product margins of lasers and disposable handpieces vary only slightly, the change in composition of our revenue did not significantly affect our gross margin.

Research and Development

Research and development expenditures of $5,065,000 decreased $6,288,000 or 55% for the year ended December 31, 2000 when compared to $11,353,000 for the year ended December 31, 1999. The decrease in overall research and development expense is comprised of a $4,875,000 reduction in expenses related to clinical trials, a $675,000 reduction in engineering project expenses and a $725,000 reduction in employee related expenses as headcount has fallen through general attrition. We expect research and development expenses to continue to decline in the upcoming year with a continuing reduction in clinical and product development activities.

Sales and Marketing

Sales and marketing expenditures of $15,349,000 decreased $1,204,000 or 7% for the year ended December 31, 2000 when compared to $16,553,000 for the year ended December 31, 1999. The decrease in absolute sales and marketing dollars is mainly due to commission payments made for laser sales. Not only was laser revenue in 2000 $8,700,000 lower than in 1999, the average commission rate on the year 2000 laser sales was substantially lower due to the transition from an outside distributor to an inside sales force for a region of the US at the end of 1999. We expect that spending on sales and marketing will decrease in the upcoming year,

despite continued development of the TMR and PMR market, as the Company's focus on cost reduction becomes reflected in lower expenditures for outside services and travel costs. At year-end a sales force transition was underway which is expected to continue through the second quarter of 2001. New sales representatives are being hired to fill openings resulting from general attrition and the release of sales representatives who did not meet their sales objectives.

General and Administrative

General and administrative expenses decreased by $1,368,000 or 17% to $6,660,000 in 2000 from $8,028,000 in 1999. The decrease is due mainly to a $1,000,000 reduction of salary and wage expense associated with the elimination of redundant positions that existed between the former CardioGenesis Corporation and us prior to the March 17, 1999 merger and with the CEO position that was filled for only a portion of 2000. Another significant reduction was an $850,000 reduction in bad debt expense. We expect general and administrative expenses to decline somewhat from prior year levels as we anticipate reductions in deferred compensation and bad debt expense and we plan to outsource patent work.

Merger Related Costs

There were no merger related costs in 2000 associated with the merger between us and the former CardioGenesis Corporation, while in 1999 there was $5,214,000 in merger related costs.

Interest and Other Income (Expense), Net

Interest and other income of $400,000 decreased $401,000 or 50% for the year ended December 31, 2000 when compared to $801,000 for the year ended December 31, 1999. The decrease was due to lower investments in marketable securities and cash and cash equivalents.

Interest expense of $32,000 decreased $32,000 or 50% for the year ended December 31, 2000 when compared to $64,000 for the year ended December 31, 1999. This decrease reflects a lower level of debt outstanding.

Equity in net loss of investee is a new non-cash expense in 2000. It represents our share of the net loss of Microheart Holdings, Inc., given our November 15, 2000 exercise of warrants to increase our ownership percentage to 32.1%.

YEAR ENDED DECEMBER 31, 1999 COMPARED TO YEAR ENDED DECEMBER 31, 1998

Net Revenues

Net revenues of $25,324,000 for the year ended December 31, 1999 increased $10,244,000 or 68% when compared to net revenues of $15,080,000 for the year ended December 31, 1998. The increase in revenues was due to $7,300,000 in higher sales of laser systems and $2,580,000 in higher sales of disposable products resulting from the receipt of FDA approval on our TMR products and an increase in research revenue associated with the sale of intellectual property of $310,000. Upon receipt of FDA approval, demand for the TMR 2000 laser system and Sologrip II disposable handpiece increased. Not only did existing sites who were cleared to perform TMR commercially begin to order more disposable devices, a large influx of new customers was added which increased the number of laser systems we shipped and in turn increased the number of handpieces sold. Export sales accounted for approximately 14% and 24% of total sales for the years ended December 31, 1999 and 1998, respectively. The percentage decrease relative to total sales is mainly due to higher domestic sales from the receipt of FDA approval on our TMR products, as international sales fell by only $30,000. We define export sales as sales to customers located outside of the United States. (See "-- Risk Factors.")

Gross Profit

Gross profit increased to $12,078,000, $14,601,000 net of the merger related inventory write-offs and a laser upgrade program or 58% of net revenues for the year ended December 31, 1999, as compared to $7,212,000 or 48% of net revenues for the year ended December 31, 1998, an increase of $7,389,000. This increase both in percentage and in absolute terms resulted from greater unit sales volume and a higher average sales price on lasers and disposables; these factors increased gross margin by approximately $3,100,000 and $3,800,000, respectively. Lower unit cost contributed an additional $500,000 towards gross margin, as the fixed manufacturing expense were applied over higher production volumes. Gross profit percentage, including the inventory and upgrade program write-off related to the merger, was 48% of net revenues.

Research and Development

Research and development expenditures of $11,353,000 decreased $18,508,000 or 62% for the year ended December 31, 1999 when compared to $29,861,000 for the year ended December 31, 1998. The decrease in these expenses reflects cost savings resulting from the merger with the former CardioGenesis Corporation by the elimination of redundant TMR and PMR clinical trials, engineering and clinical support activity of $2 million, $8 million and $2 million, respectively. There was an additional $6 million of clinical expense reductions during 1999 attributed to the completion of major trials in 1998 and early 1999.

Sales and Marketing

Sales and Marketing expenditures of $16,553,000 decreased $1,110,000 or 6% for the year ended December 31, 1999 when compared to $17,663,000 for the year ended December 31, 1998. The decrease in absolute dollars is mainly due to cost efficiencies realized from the merger. Prior to the merger, both we and the former CardioGenesis Corporation were operating separate sales units in Europe. Cost savings from the elimination of this redundancy was approximately $1.5 million. This savings is partially offset by $250,000 in increased general marketing expenses supporting the commercial TMR products and $200,000 in increased commissions.

General and Administrative

General and administrative expenses decreased by $2,793,000 or 26% to $8,028,000 in 1999 from $10,821,000 in 1998. The decrease is due to a $3.5 million reduction in litigation expenses offset by a $700,000 increase in deferred compensation to consultants.

Merger Related Costs

The former CardioGenesis Corporation was a medical device company like us, which developed, manufactured, and marketed cardiac revascularization products for the treatment of advanced cardiovascular disease and severe angina pain through TMR and PMR. The former CardioGenesis Corporation also manufactured and marketed disposable products to perform intraoperative transmyocardial revascularization, catheter-based percutaneous myocardial revascularization, and thorascopic transmyocardial revascularization to treat patients afflicted with debilitating angina. During the quarter ended March 31, 1999, we recognized merger-related costs of $6,893,000 for financial advisory and legal fees, personnel severance, terminated relationships and other costs including write-offs of fixed assets and inventory. A majority of the terminated employees were located in California and worked in operations, sales, marketing, quality, research and development and administrative functions. A total of 40 employees were terminated.

During the remaining three quarters in the year ended December 31, 1999, we recognized additional merger-related costs of $844,000, which was mainly due to an upgrade program to replace customer owned equipment rendered unusable by the merger. This increase brought the total of merger related costs for the twelve

months ended December 31, 1999 to $7,737,000; this includes inventory write-offs and the laser upgrade program totaling $2,523,000 that are accounted for in our cost of revenues. We do not expect any further charges for merger related expense and anticipate the last merger-related payment to occur in the second part of 2001. The following table summarizes the merger-related costs (in thousands).

DESCRIPTION	AMOUNT
Financial advisory and legal fees	$ 2,528
Personnel severance	1,190
Terminated relationships/contracts	910
Other costs including laser upgrade program and fixed asset and inventory write-offs	3,109
Subtotal	7,737
Less: Amount included in cost of revenues	(2,523)
Total	$ 5,214

Interest and Other Income (Expense), Net

Interest and other income of $801,000 decreased $2,653,000 or 77% for the year ended December 31, 1999 when compared to $3,454,000 for the year ended December 31, 1998. The decrease was due to lower investments in marketable securities and cash and cash equivalents.

Interest expense of $64,000 decreased $24,000 or 27% for the year ended December 31, 1999 when compared to $88,000 for the year ended December 31, 1998. This decrease reflects a lower level of debt outstanding.

LIQUIDITY AND CAPITAL RESOURCES

Cash, cash equivalents and short and long-term marketable securities were $3,357,000 at December 31, 2000 compared to $13,313,000 at December 31, 1999, a decrease of 75%. We used $12,281,000 of cash for operating activities, including funding our operating loss and decreases in accrued liabilities in 2000.

Accounts receivable of $3,654,000 at December 31, 2000 decreased 56% to $8,119,000 at December 31, 1999, even though annual sales only decreased by 12% when comparing the same periods. The decrease in accounts receivable is attributed to a decrease in sales in the three month period ending December 31, 2000 as compared to the same period ending in 1999. Non-current accounts receivable of $119,000 at December 31, 2000 decreased 89% to $1,125,000 at December 31, 1999. Non-current accounts receivable is comprised of leases that were recognized in prior years.

Inventories decreased by $1,583,000 or 23% to $5,400,000 at December 31, 2000 from a level of $6,983,000 at December 31, 1999. This decrease is mainly due to a reduction of $900,000 in gross inventory from lower purchases of raw materials relative to inventory outflows via cost of revenues, along with the addition of $670,000 of inventory reserves.

Inventory reserves increased by $182,000 to $2,180,000 at December 31, 2000 compared to $1,998,000 at December 31, 1999. During the year, approximately $673,000 of new reserves were accrued, with $360,000 of this amount attributed to lasers in Europe for which there was no intent to sell and $180,000 of the reserve being attributed to raw materials held in excess of current requirements. Reserve balances were reduced during the year by write-offs of approximately $491,000 for obsolete and out-of-date material.

As of December 31, 2000, there were reserves of $2,180,000 against gross inventory of $7,580,000 for a reserve percentage of 29%. Approximately $980,000 of these reserves relates to lasers in Europe for which there was no intent to sell, while $600,000 is reserved for raw materials in excess of current requirements and $440,000

is reserved for service/obsolete inventory. The Company is closely monitoring its inventory levels with a view to balancing outlays for raw materials with sales requirements.

Investing activities, consisting primarily of purchases and sale of marketable securities and additions to property and equipment, provided cash of $6,700,000, $16,100,000 and $28,400,000 in fiscal years 2000, 1999, and 1998 respectively. In the fourth quarter of 2000, we increased our ownership interest in privately-held MicroHeart Holdings, Inc. to 32.1% for cash compensation of $310,000. The investment in MicroHeart is accounted for under the equity method. As of December 31, 2000, we recorded a net loss of $58,000, which represents CardioGenesis' equity in the loss incurred by MicroHeart. Financing activities provided cash of $3,400,000, $8,400,000 and $1,300,000 in fiscal years 2000, 1999 and 1998 respectively primarily from the issuance of common stock pursuant to exercise of stock options and warrants and the issuance of common stock.

Since our inception, we have satisfied our capital requirements primarily through sales of our equity securities. In addition, our operation has been funded in part through sales of our products.

In September 2000, we sold 526,496 shares of our common stock to Acqua Wellington at a negotiated purchase price of $3.7987 per share. We did not pay any other compensation in conjunction with the sale of our common stock.

In March 2001, we sold 898,202 shares of common stock to Acqua Wellington at a negotiated purchase price of $1.1133 per share. We did not pay any other compensation in conjunction with the sale of our common stock. In April 2001, the Board adopted an amendment to our Bylaws which precludes the Company from entering into or exercising any rights under any equity line agreement, including the Acqua Wellington equity line agreement, unless approval from the shareholders holding a majority of the shares is obtained.

In April 2001, we sold 2,000,000 shares of common stock to an institutional entity at a negotiated purchase price of $1.00 per share. We did not pay any other compensation in conjunction with the sale of our common stock.

We have incurred significant losses for the last several years and at December 31, 2000 have an accumulated deficit of $153,833,000. The accompanying financial statements have been prepared assuming we will continue as a going concern. Our ability to continue as a going concern is dependent upon achieving profitable operations in the future. Our plans include increasing sales through increased direct sales and marketing efforts on existing products and achieving timely regulatory approval for certain other products under clinical trials.

We also plan to continue our cost containment efforts that are focused on reducing our cost of revenues and on bringing operating expenses in line with our revenues. In order to reduce our cost of revenues, we have focused our efforts on the following activities: (i) downsizing the manufacturing work force to levels consistent with current production activity; (ii) simplifying and improving manufacturing procedures; and (iii) reducing the number of products offered for sale worldwide. In order to reduce our operating expenses, we have focused our efforts on reducing headcount in functions that are not essential to critical activities.

Currently, a priority of the Company is to achieve break-even followed by profitability within a relatively short span of time. In many respects, the Company's actions have been guided by this imperative, and the resulting cost containment measures have helped to conserve our cash. The focus of the Company is upon critical activities. Production activities or operating expenses that are nonessential to our core operations have been, or are in the process of being, eliminated.

We have recognized the need for infusion of cash. In September 2000, March 2001 and April 2001, we raised approximately $1,873,000, $1,000,000 and $1,925,000, respectively, net of estimated offering costs, from the sale of shares of common stock. In April 2001, we received a non-binding letter of intent from a business credit financing company regarding an asset-based financing agreement current level of which will provide an estimated $1,000,000 of additional financing based upon current level of our qualified domestic accounts

receivable which will serve as collateral. We believe that if revenue from sales or new funds from debt or equity instruments is insufficient to maintain the current expenditure rate, it will be necessary to significantly reduce our operations until an appropriate solution is implemented.

QUARTERLY RESULTS OF OPERATIONS

The following table sets forth certain quarterly financial information for the periods indicated. This information has been derived from unaudited financial statements that, in the opinion of management, have been prepared on the same basis as the audited information, and includes all normal recurring adjustments necessary for a fair presentation of such information. The results of operations for any quarter are not necessarily indicative of the results to be expected for any future periods.

	THREE MONTHS ENDED						
	2000				1999		
	MARCH 31	JUNE 30	SEPT. 30	DEC. 31	MARCH 31	JUNE 30	SEPT. 30
Net revenues.......	$ 5,677	$ 6,608	$ 5,014	$ 4,911	$ 4,474	$ 7,190	$ 6,085
Gross profit.......	3,346	3,910	2,554	2,345	1,177 (a)	3,695 (b)	2,954 (c)
Operating loss.....	(4,546)	(3,398)	(3,800)	(3,175)	(15,474)(a)	(4,339)(b)	(4,982)(c)
Net loss...........	(4,439)	(3,262)	(3,744)	(3,164)	(15,166)(a)	(4,201)(b)	(4,906)(c)
Net loss per share:							
Basic and diluted.	(0.15)	(0.11)	(0.13)	(0.10)	(0.55)	(0.15)	(0.17)
Weighted average shares outstanding.	29,664	30,064	30,191	30,729	27,576	28,086	28,591

(a) Gross profit includes cost of revenues of $1,392,000 related to inventory and fixed asset write-offs in connection with the merger. Operating loss includes merger-related costs of $5,501,000. Net loss includes cost of revenues of $1,392,000 related to inventory write-offs in connection with the merger and merger-related costs of $5,501,000.

(b) Gross profit includes cost of revenues of $625,000 related to a laser upgrade program in connection with the merger. Operating loss includes a reversal of a previously recorded reserve of $541,000. Net loss includes cost of revenues of $625,000 related to a laser upgrade program in connection with the merger and a reversal of a previously recorded reserve of $541,000.

(c) Gross profit includes cost of revenues of $179,000 related to a laser upgrade program in connection with the merger. Operating loss includes merger-related costs of $257,000. Net loss includes cost of revenues of $179,000 related to a laser upgrade program in connection with the merger and merger-related costs of $257,000.

(d) Gross profit includes cost of revenues of $327,000 related to a laser upgrade program in connection with the merger. Operating loss includes a reversal of a previously recorded reserve of $4,000. Net loss includes cost of revenues of $327,000 related to a laser upgrade program in connection with the merger and a reversal of a previously recorded reserve of $4,000.

RECENTLY ISSUED ACCOUNTING STANDARDS

In June 1998, the Financial Accounting Standards Board issued SFAS 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS 133 establishes new standards of accounting and reporting for derivative instruments and hedging activities. SFAS 133 requires that all derivatives be recognized at fair value in the statement of financial position, and that the corresponding gains or losses be reported either in the statement of operations or as a component of comprehensive income, depending on the type of hedging relationship that exists. We do not currently hold derivative instruments or engage in hedging activities. We will adopt SFAS 133 in the first quarter of 2001 and we do not believe that the initial adoption will have a material impact on the financial statements.

In March 2000, the Financial Accounting Standards Board issued Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation - an Interpretation of APB 25." FIN 44 provides updated accounting guidance regarding implementing and interpreting APB 25, and should be applied on a prospective basis from July 1, 2000. The Company's adoption of this pronouncement had no impact on the Company's financial position or results of operations.

FACTORS AFFECTING FUTURE RESULTS

In addition to the other information included in this Form 10-K, the following risk factors should be considered carefully in evaluating us and our business.

OUR ABILITY TO CONTINUE AS A GOING CONCERN IS DEPENDENT UPON ACHIEVING PROFITABLE OPERATIONS IN THE FUTURE.

We will have a continuing need for new infusions of cash until revenues are increased to meet our operating expenses. We plan to increase our sales through increased direct sales and marketing efforts on existing products and achieving timely regulatory approval for other products under clinical trials.

If we are unable to increase our sales or achieve timely regulatory approval for our products, we will be unable to significantly increase our revenues. We believe that if we are unable to generate sufficient funds from sales or from debt or equity issuances to maintain our current expenditure rate, it will be necessary to significantly reduce our operations. This would raise substantial doubt about our ability to continue as a going concern. We may be required to seek additional sources of financing, which could include short-term debt, long-term debt or equity. There is a risk that we may be unsuccessful in obtaining such financing and will not have sufficient cash to fund our operations.

WE MAY FAIL TO OBTAIN REQUIRED REGULATORY APPROVALS TO MARKET OUR PRODUCTS INCLUDING OUR PMR LASER SYSTEM IN THE UNITED STATES.

Our business could be harmed if any of the following events, circumstances or occurrences related to the regulatory process occurred thereby causing a reduction in our revenues:

- the failure to obtain regulatory approvals for our PMR system;

- significant limitations in the indicated uses for which our products may be marketed;

- substantial costs incurred in obtaining regulatory approvals.

The Food and Drug Administration has not approved our PMR laser systems for any application in the United States. The PMR study compares PMR to conventional medical therapy in patients with no option for other treatment. The Food and Drug Administration may not accept the study as safe and effective, and PMR may not be approved for commercial use in the United States. Responding to Food and Drug Administration requests for additional information could require substantial financial and management resources and take several years.

In October 2000, preliminary results from a competitor's clinical trial of a catheter-based device employing Direct Myocardial Revascularization also known as DMR were presented at a medical conference in Washington D.C. The trial's principal investigator concluded that this catheter-based device did not show significant evidence of clinical benefit with regard to angina class reduction or exercise tolerance, and questioned the efficacy of other devices and

procedures relying on TMR. We believe that the preliminary results of that catheter-based device study should not call the results of our PMR study into question because the devices and procedures are substantially different. We cannot assure you, however, that the preliminary results of that catheter-based device study will impact the Food and Drug Administration's decision on our PMR system.

THE MEDICAL COMMUNITY HAS NOT BROADLY ADOPTED OUR PRODUCTS, AND UNLESS OUR PRODUCTS ARE BROADLY ADOPTED, OUR BUSINESS WILL SUFFER.

Our TMR products have not yet achieved broad commercial adoption, and our PMR products are experimental and have not yet achieved broad clinical adoption. We cannot predict whether or at what rate and how broadly our products will be adopted by the medical community. Our business would be harmed if our TMR and PMR systems fail to achieve significant market acceptance.

THE RECEIPT OF POSITIVE ENDORSEMENTS BY PHYSICIANS IS ESSENTIAL FOR THE SUCCESS OF OUR PRODUCTS IN THE MARKET PLACE.

Positive endorsements, by physicians, are essential for clinical adoption of our TMR and PMR laser systems. Even if the clinical efficacy of TMR and PMR laser systems is established, physicians may elect not to recommend TMR and PMR laser systems for any number of reasons.

Clinical adoption of these products will depend upon:

- our ability to facilitate training of cardiothoracic surgeons and interventional cardiologists in TMR and PMR therapy;

- willingness of such physicians to adopt and recommend such procedures to their patients; and

- raising the awareness of TMR and then PMR with the targeted patient population.

Patient acceptance of the procedure will depend on:

- physician recommendations;

- the degree of invasiveness;

- the effectiveness of the procedure; and

- the rate and severity of complications associated with the procedure as compared to other procedures.

TO EXPAND OUR BUSINESS, WE MUST ESTABLISH EFFECTIVE SALES, MARKETING AND DISTRIBUTION SYSTEMS.

To expand our business, we must establish effective systems to sell, market and distribute products. To date, we have had limited sales which have consisted primarily of U.S. sales of our TMR lasers and disposable handpieces on a commercial basis since February 1999 and PMR lasers and disposable catheters for investigational use only. We have been expanding our operations by hiring additional sales and marketing personnel. This has required and will continue to require substantial management effort and financial resources.

IF OUR SALES FORCE IS NOT SUCCESSFUL IN INCREASING MARKET SHARE AND SELLING OUR DISPOSABLE HANDPIECES, OUR BUSINESS WILL SUFFER.

With Food and Drug Administration approval of our TMR laser system, we are marketing our products primarily through our direct sales force. If the sales force is not successful in increasing market share and selling our disposable handpieces, our business will suffer. In the fourth quarter of 1999, we changed our U.S. sales strategy to include both selling lasers to hospitals outright, as well as loaning lasers to hospitals in return for the hospital purchasing a minimum number of disposable handpieces at a higher price. During the current year, the majority of lasers shipped have been under this loan program. The purpose of this strategy is to focus our sales force on increasing market penetration and selling disposable handpieces used in connection with our TMR procedure.

THE EXPANSION OF OUR BUSINESS MAY PUT ADDED PRESSURE ON OUR MANAGEMENT AND OPERATIONAL INFRASTRUCTURE AFFECTING OUR ABILITY TO MEET ANY INCREASED DEMAND FOR OUR PRODUCTS AND POSSIBLY HAVING AN ADVERSE EFFECT ON OUR OPERATING RESULTS.

The growth in our business may place a significant strain on our limited personnel, management, financial systems and other resources. The evolving growth of our business presents numerous risks and challenges, including:

- the dependence on the growth of the market for our TMR and PMR systems;

- our ability to successfully and rapidly expand sales to potential customers in response to increasing clinical adoption of the TMR procedure;

- the costs associated with such growth, which are difficult to quantify, but could be significant;

- domestic and international regulatory developments;

- rapid technological change;

- completing the clinical trials that are currently in progress as well as developing and preparing additional products for clinical trials;

- the highly competitive nature of the medical devices industry; and

- the risk of entering emerging markets in which we have limited or no direct experience.

To accommodate any such growth and compete effectively, we must obtain additional funding to improve information systems, procedures and controls and expand, train, motivate and manage our employees, and such funding may not be available in sufficient quantities, if at all. If we are not able to manage these activities and implement these strategies successfully to expand to meet any increased demand, our operating results could suffer.

OUR OPERATING RESULTS ARE EXPECTED TO FLUCTUATE AND QUARTER-TO-QUARTER COMPARISONS OF OUR RESULTS MAY NOT INDICATE FUTURE PERFORMANCE.

Our operating results have fluctuated significantly from quarter-to-quarter and are expected to fluctuate significantly from quarter-to-quarter due to a number of events and factors, including:

- the level of product demand and the timing of customer orders;

- changes in strategy;

- delays associated with the Food and Drug Administration and other regulatory approval processes;

- personnel changes including our ability to continue to attract, train and motivate additional qualified personnel in all areas;

- the level of international sales;

- changes in competitive pricing policies;

- the ability to develop, introduce and market new and enhanced versions of products on a timely basis;

- deferrals in customer orders in anticipation of new or enhanced products;

- product quality problems; and

- the enactment of health care reform legislation and any changes in third party reimbursement policies.

We believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. Due to the emerging nature of the markets in which we compete, forecasting operating results is difficult and unreliable. Over the past year, our revenue has been lower than anticipated, largely attributable to the transition to our new sales strategy. It is likely or possible that our operating results for a future quarter will fall below the

expectations of public market analysts and investors. When this occurred in the past, the price of our common stock fell substantially, and if this occurs again, the price of our common stock may fall again, perhaps substantially.

GROWTH IN OUR FUTURE OPERATING RESULTS IS HIGHLY CONTINGENT AND SUBJECT TO SIGNIFICANT RISKS.

Our future operating results will be significantly affected by our ability to:

- successfully and rapidly expand sales to potential customers;

- implement operating, manufacturing and financial procedures and controls;

- improve coordination among different operating functions; and,

- achieve manufacturing efficiencies as production volume increases.

WE MAY NOT BE ABLE TO SUCCESSFULLY MARKET OUR PRODUCTS IF THIRD PARTY REIMBURSEMENT FOR THE PROCEDURES PERFORMED WITH OUR PRODUCTS IS NOT AVAILABLE FOR OUR HEALTH CARE PROVIDER CUSTOMERS.

Few individuals are able to pay directly for the costs associated with the use of our products. In the United States, hospitals, physicians and other healthcare providers that purchase medical devices generally rely on third party payors, such as Medicare, to reimburse all or part of the cost of the procedure in which the medical device is being used.

Effective July 1, 1999 the Health Care Financing Administration commenced Medicare coverage for TMR systems for any manufacturer's TMR procedures. Hospitals and physicians are now eligible to receive Medicare reimbursement covering 100% of the costs for TMR procedures and equipment. The Health Care Financing Administration may not approve reimbursement for PMR. If it does not provide reimbursement, our ability to successfully market and sell our PMR products will be harmed. We have limited experience to date with the acceptability of our TMR procedures for reimbursement by private insurance and private health plans and thus do not have reliable data as to the success of our patients in obtaining reimbursement for the costs of our TMR products outside of the Medicare system. Private insurance and private health plans may not approve reimbursement TMR or PMR procedures. If they do not provide reimbursement, our business will suffer.

Potential purchasers must determine whether the clinical benefits of our TMR and PMR laser systems justify:

- the additional cost or the additional effort required to obtain prior authorization or coverage; and

- the uncertainty of actually obtaining such authorization or coverage.

WE FACE COMPETITION FROM OUR COMPETITOR'S PRODUCTS WHICH COULD LIMIT MARKET ACCEPTANCE OF OUR PRODUCTS AND RENDER OUR PRODUCTS OBSOLETE.

The market for TMR laser systems is competitive. If our competitor is more effective in developing new products and procedures and marketing existing and future products, our business will suffer. The market for TMR laser systems is characterized by rapid technical innovation. Accordingly, our current or future competitors may succeed in developing TMR products or procedures that:

- are more effective than our products;

- are more effectively marketed than our products; or

- may render our products or technology obsolete.

We currently compete with PLC Systems. PLC recently announced a co-marketing agreement with Edwards Life Sciences to distribute their lasers and disposables which is expected to add another 18 direct domestic sales representatives involved in promoting the PLC technology.

Even with the Food and Drug Administration approval for our TMR laser system, we will face competition for market acceptance and market share for that product. Our ability to compete may depend in significant part on the

timing of introduction of competitive products into the market, and will be affected by the pace, relative to competitors, at which we are able to:

- develop products;

- complete clinical testing and regulatory approval processes;

- obtain third party reimbursement acceptance; and

- supply adequate quantities of the product to the market.

OUR PRODUCTS DEPEND ON TMR TECHNOLOGY THAT IS RAPIDLY CHANGING WHICH MAY REQUIRE US TO INCUR SUBSTANTIAL PRODUCT DEVELOPMENT EXPENDITURES TO PREVENT OUR PRODUCTS FROM BECOMING OBSOLETE.

The medical device industry is characterized by rapid and significant technological change. Our future success will depend in large part on our ability to respond to such changes through further product research and development. In addition, we must expand the indications and applications for our products by developing and introducing enhanced and new versions of our TMR and PMR laser systems. Product research and development requires substantial expenditures and is inherently risky. We may not be able to:

- identify products for which demand exists; or

- develop products that have the characteristics necessary to treat particular indications.

OVERALL INCREASES IN MEDICAL COSTS COULD ADVERSELY AFFECT OUR BUSINESS.

We believe that the overall escalating cost of medical products and services has led, and will continue to lead, to increased pressures on the health care industry, both foreign and domestic, to reduce the cost of products and services, including products offered by them. We cannot assure you that in either United States or international markets that:

- third party reimbursement and coverage will be available or adequate;

- current reimbursement amounts will not be decreased in the future; or

- future legislation, regulation or reimbursement policies of third party payors will not otherwise adversely affect the demand for our products or our ability to profitably sell our products.

Fundamental reforms in the healthcare industry in the United States and Europe continue to be considered. We cannot predict whether or when any healthcare reform proposals will be adopted and what effect such proposals might have on our business.

WE HAVE A HISTORY OF LOSSES AND MAY NOT BE PROFITABLE IN THE FUTURE.

We have incurred significant losses since inception. Our revenues and operating income will be constrained:

- until such time, if ever, as we obtain broad commercial adoption of our TMR laser systems by healthcare facilities in the United States;

- until such time, if ever, as we obtain Food and Drug Administration and other regulatory approvals for our PMR laser systems; and

- for an uncertain period of time after such approvals are obtained.

We may not achieve or sustain profitability in the future.

THIRD PARTIES MAY LIMIT THE DEVELOPMENT AND PROTECTION OF OUR INTELLECTUAL PROPERTY, WHICH COULD ADVERSELY AFFECT OUR COMPETITIVE POSITION.

Our success is dependent in large part on our ability to:

- obtain patent protection for our products and processes;

- preserve our trade secrets and proprietary technology; and
- operate without infringing upon the patents or proprietary rights of third parties.

The medical device industry has been characterized by extensive litigation regarding patents and other intellectual property rights. Companies in the medical device industry have employed intellectual property litigation to gain a competitive advantage. Certain competitors and potential competitors of ours have obtained United States patents covering technology that could be used for certain TMR and PMR procedures. We do not know if such competitors, potential competitors or others have filed and hold international patents covering other TMR or PMR technology. In addition, international patents may not be interpreted the same as any counterpart United States patents.

In September 1995, one of our competitors sent us a notice of potential infringement of their patent regarding a method for TMR utilizing synchronization of laser pulses to the electrical signals from the heart. After discussion with patent counsel, we concluded that we did not utilize the process and/or apparatus that was the subject of the patent at issue, and we provided a response to the competitor to that effect. We have not received any additional correspondence from this competitor on these matters.

In 1996, prior to the merger with us, the company formerly known as CardioGenesis Corporation initiated a suit in the United States against PLC seeking a judgment that the PLC patent is invalid and unenforceable. In 1997, PLC counterclaimed in that suit alleging infringement by the former CardioGenesis Corporation of the PLC patent. Also in 1997, PLC initiated suit in Germany against the former CardioGenesis Corporation and the former CardioGenesis Corporation's former German sales agent alleging infringement of a European counterpart to the PLC patent. In 1997, the former CardioGenesis Corporation filed an Opposition in the European Patent Office to a European counterpart to the PLC patent, seeking to have the European patent declared invalid.

On January 5, 1999, before trial on the United States suit commenced, the company formerly known as CardioGenesis Corporation and PLC settled all litigation between them, both in the United States and in Germany, with respect to the PLC patent and the European patents. Under the Settlement and License Agreement signed by the parties, the former CardioGenesis Corporation stipulated to the validity of the PLC patents and PLC granted CardioGenesis a non-exclusive worldwide license to the PLC patents. The former CardioGenesis Corporation agreed to pay PLC a license fee, and minimum royalties, totaling $2.5 million in equal monthly installments over an approximately forty-month period, with a running royalty credited against the minimums.

The Settlement and License Agreement applies only to those products or that technology covered by the PLC patents, and the agreement does not provide PLC any rights to any former CardioGenesis Corporation intellectual property. Our TMR 2000 laser system does not use the technology associated with the PLC patents.

While we periodically review the scope of our patents and other relevant patents of which we are aware, the question of patent infringement involves complex legal and factual issues. Any conclusion regarding infringement may not be consistent with the resolution of any such issues by a court.

COSTLY LITIGATION MAY BE NECESSARY TO PROTECT INTELLECTUAL PROPERTY RIGHTS.

We may have to engage in time consuming and costly litigation to protect our intellectual property rights or to determine the proprietary rights of others. In addition, we may become subject to patent infringement claims or litigation, or interference proceedings declared by the United States Patent and Trademark Office to determine the priority of inventions.

Defending and prosecuting intellectual property suits, United States Patent and Trademark Office interference proceedings and related legal and administrative proceedings are both costly and time-consuming. We may be required to litigate further to:

- enforce our issued patents;

- protect our trade secrets or know-how; or

- determine the enforceability, scope and validity of the proprietary rights of others.

Any litigation or interference proceedings will result in substantial expense and significant diversion of effort by technical and management personnel. If the results of such litigation or interference proceedings are adverse to us, then the results may:

- subject us to significant liabilities to third parties;

- require us to seek licenses from third parties;

- prevent us from selling our products in certain markets or at all; or

- require us to modify our products.

Although patent and intellectual property disputes regarding medical devices are often settled through licensing and similar arrangements, costs associated with such arrangements may be substantial and could include ongoing royalties. Furthermore, we may not be able to obtain the necessary licenses on satisfactory terms, if at all.

Adverse determinations in a judicial or administrative proceeding or failure to obtain necessary licenses could prevent us from manufacturing and selling our products. This would harm our business.

The United States patent laws have been amended to exempt physicians, other health care professionals, and affiliated entities from infringement liability for medical and surgical procedures performed on patients. We are not able to predict if this exemption will materially affect our ability to protect our proprietary methods and procedures.

WE RELY ON PATENT AND TRADE SECRET LAWS, WHICH ARE COMPLEX AND MAY BE DIFFICULT TO ENFORCE.

The validity and breadth of claims in medical technology patents involve complex legal and factual questions and, therefore, may be highly uncertain. Issued patent or patents based on pending patent applications or any future patent application may not exclude competitors or may not provide a competitive advantage to us. In addition, patents issued or licensed to us may not be held valid if subsequently challenged and others may claim rights in or ownership of such patents.

Furthermore, we cannot assure you that our competitors:

- have not developed or will not develop similar products;

- will not duplicate our products; or

- will not design around any patents issued to or licensed by us.

Because patent applications in the United States were, until recently, maintained in secrecy until patents issue, we cannot be certain that:

- others did not first file applications for inventions covered by our pending patent applications; or

- we will not infringe any patents that may issue to others on such applications.

WE DEPEND ON SINGLE SOURCE SUPPLIERS FOR KEY COMPONENTS AND PRODUCTION WOULD BE INTERRUPTED IF A KEY SUPPLIER HAD TO BE REPLACED.

We currently purchase critical laser and fiber-optic components from single sources. These sources may have difficulties supplying our needs for these components. In addition, we do not have long term supply contracts. As a result, these sources are not obligated to continue to provide these critical components to us. Although we have identified alternative suppliers, a lengthy process would be required to qualify them as additional or replacement suppliers. Any significant interruption in the supply of critical materials or components could delay our ability to manufacture our products and could disrupt our manufacturing operations and harm our business.

LEAD TIMES FOR MATERIALS AND COMPONENTS VARY SIGNIFICANTLY WHICH COULD LEAD TO EXCESS INVENTORY LEVELS AS WELL AS SHORTAGES OF CRITICAL COMPONENTS IF OUR SUPPLY FORECASTS ARE INACCURATE.

We anticipate that products will be manufactured based on forecasted demand and will seek to purchase subassemblies and components in anticipation of the actual receipt of purchase orders from customers. Lead times for materials and components vary significantly and depend on factors such as the business practices of each specific supplier and the terms of particular contracts, as well as the overall market demand for such materials and components at any given time. If the forecasts are inaccurate, we could experience fluctuations in inventory levels, resulting in excess inventory, or shortages of critical components, either of which could cause our business to suffer.

WE MAY NOT BE ABLE TO MEET FUTURE DEMAND INCREASES ON TIMELY BASIS BECAUSE SOME OF OUR SUPPLIERS COULD HAVE DIFFICULTY MEETING SIGNIFICANT OR RAPIDLY INCREASING ORDER AMOUNTS.

Some of our suppliers could have difficulty expanding their manufacturing capacity to meet our needs if demand for our TMR and PMR laser systems were to increase rapidly or significantly. In addition, any defect or malfunction in the laser or other products provided by such suppliers could cause a delay in regulatory approvals or adversely affect product acceptance. We cannot predict if:

- materials obtained from outside suppliers will be available in adequate quantities to meet our future needs; or

- replacement suppliers can be qualified on a timely basis if our current suppliers are unable to meet our needs.

WE HAVE LIMITED MANUFACTURING EXPERIENCE WHICH COULD PREVENT US FROM SUCCESSFULLY INCREASING CAPACITY IN RESPONSE TO MARKET DEMAND.

We have limited experience in manufacturing products. In the course of manufacturing our products, we may encounter difficulties in increasing production, including problems involving:

- production yields;

- adequate supplies of components;

- achieving manufacturing efficiencies as production volume increases;

- quality control and assurance (including failure to comply with good manufacturing practices regulations, international quality standards and other regulatory requirements); and

- shortages of qualified personnel.

OUR PRODUCTS MAY CONTAIN DEFECTS WHICH COULD DELAY REGULATORY APPROVAL OR MARKET ACCEPTANCE OF OUR PRODUCTS.

We may experience future product defects, malfunctions, manufacturing difficulties or recalls related to the lasers or other components used in our TMR and PMR laser systems. Any such occurrence could cause a delay in regulatory approvals or adversely affect the commercial acceptance of our products. We are unable to quantify the likelihood or costs of any such occurrences, but they could potentially be significant. Our business could be harmed because we may be unable to sufficiently remedy a significant product recall while still maintaining our daily manufacturing quotas.

WE MUST COMPLY WITH FOOD AND DRUG ADMINISTRATION MANUFACTURING STANDARDS OR FACE FINES OR OTHER PENALTIES INCLUDING SUSPENSION OF PRODUCTION.

We are required to demonstrate compliance with the Food and Drug Administration's current good manufacturing practices regulations if we market devices in the United States or manufacture finished devices in the United States. The Food and Drug Administration inspects manufacturing facilities on a regular basis to determine compliance. If we fail to comply with applicable Food and Drug Administration or other regulatory requirements, we can be subject to:

- fines, injunctions, and civil penalties;

- recalls or seizures of products;

- total or partial suspensions of production; and

- criminal prosecutions.

The impact on the company of any such failure to comply would depend on the impact of the remedy imposed on us.

WE MAY SUFFER LOSSES FROM PRODUCT LIABILITY CLAIMS IF OUR PRODUCTS CAUSE HARM TO PATIENTS.

We are exposed to potential product liability claims and product recalls. These risks are inherent in the design, development, manufacture and marketing of medical devices. Our products are designed to be used in life-threatening situations where there is a high risk of serious injury or death, and we could be subject to product liability claims if the use of our TMR or PMR laser systems is alleged to have caused adverse effects on a patient or such products are believed to be defective. We are not aware of any material side effects or adverse events arising from the use of our products.

Any regulatory clearance for commercial sale of these products will not remove these risks. Any failure to comply with the Food and Drug Administration's good manufacturing practices or other regulations could hurt our ability to defend against product liability lawsuits. Although we have not experienced any product liability claims to date, any such claims could cause our business to suffer.

OUR INSURANCE MAY BE INSUFFICIENT TO COVER PRODUCT LIABILITY CLAIMS AGAINST US.

Our product liability insurance may not be adequate for any future product liability problems or continue to be available on commercially reasonable terms, or at all.

If we were held liable for a product liability claim or series of claims in excess of our insurance coverage, such liability could harm our business and financial condition. We maintain insurance against product liability claims in the amount of $10 million per occurrence and $10 million in the aggregate.

We may require increased product liability coverage as sales of approved products increase and as additional products are commercialized. Product liability insurance is expensive and in the future may not be available on acceptable terms, if at all.

WE DEPEND HEAVILY ON KEY PERSONNEL AND TURNOVER OF KEY EMPLOYEES AND SENIOR MANAGEMENT COULD HARM OUR BUSINESS.

Our future business and results of operations depend in significant part upon the continued contributions of our key technical and senior management personnel. They also depend in significant part upon our ability to attract and retain additional qualified management, manufacturing, technical, marketing and sales and support personnel for our operations. If we lose a key employee or if a key employee fails to perform in his or her current position, or if we are not able to attract and retain skilled employees as needed, our business could suffer.

During the last two years, we have had significant change in our senior management team. Our former Chief Executive Officer, Allen Hill, resigned from the company in December 1999. One of our current Directors, Alan Kaganov, acted as interim CEO until we hired our current CEO, Michael Quinn, in October of 2000. Our former Chief Financial Officer, Dick Powers, resigned from the company in July 2000. Ian Johnson acted as Interim CFO until our current CFO, J. Stephen Wilkins, was hired in May 2001. Richard Lanigan moved from Vice President of Sales to Vice President of Regulatory and Government Affairs in March 2001 and Thomas Kinder was hired in March 2001 as our new Vice President of Sales. Darrell Eckstein was hired in December 2000 as our Vice President of Operations, replacing Bill Picht, who resigned earlier in 2000.

Our future business could be harmed by our turnover in senior management if we have difficulty familiarizing and training our new management with respect to our business. Further significant turnover in our senior management could significantly deplete our institutional knowledge held by our existing senior management team. We depend on the skills and abilities of these key employees in managing the manufacturing, technical, marketing and sales aspects of our business, any part of which could be harmed by further turnover.

WE MAY FAIL TO COMPLY WITH INTERNATIONAL REGULATORY REQUIREMENTS AND COULD BE SUBJECT TO REGULATORY DELAYS, FINES OR OTHER PENALTIES.

Regulatory requirements in foreign countries for international sales of medical devices often vary from country to country. In addition, the Food and Drug Administration must approve the export of devices to certain countries. The occurrence and related impact of the following factors would harm our business:

- delays in receipt of, or failure to receive, foreign regulatory approvals or clearances;

- the loss of previously obtained approvals or clearances; or

- the failure to comply with existing or future regulatory requirements.

To market in Europe, a manufacturer must obtain the certifications necessary to affix to its products the CE Marking. The CE Marking is an international symbol of adherence to quality assurance standards and compliance with applicable European medical device directives. In order to obtain and to maintain a CE Marking, a manufacturer must be in compliance with the appropriate quality assurance provisions of the International Standards Organization and obtain certification of its quality assurance systems by a recognized European Union notified body. However, certain individual countries within Europe require further approval by their national regulatory agencies.

We have achieved International Standards Organization and European Union certification for our manufacturing facility. In addition, we have completed CE mark registration for all of our products in accordance with the implementation of various medical device directives in the European Union. Failure to maintain the right to affix the CE Marking or other requisite approvals could prohibit us from selling our TMR products in member countries of the European Union or elsewhere. Any enforcement action by international regulatory authorities with respect to past or future regulatory noncompliance could cause our business to suffer. Noncompliance with international regulatory requirements could result in enforcement action such as not being allowed to market our product in the European Union, which would significantly reduce international revenue.

WE SELL OUR PRODUCTS INTERNATIONALLY WHICH SUBJECTS US TO SPECIFIC RISKS OF TRANSACTING BUSINESS IN FOREIGN COUNTRIES.

In future quarters, international sales may become a significant portion of our revenue if our products become more widely used outside of the United States according to our plan. Our international revenue is subject to the following risks, the occurrence of any of which could harm our business:

- foreign currency fluctuations;

- economic or political instability;

- foreign tax laws;

- shipping delays;
- various tariffs and trade regulations;
- restrictions and foreign medical regulations;
- customs duties, export quotas or other trade restrictions; and
- difficulty in protecting intellectual property rights.

WE MAY NOT ACHIEVE WIDE ACCEPTANCE OF OUR PRODUCTS IN FOREIGN MARKETS IF WE FAIL TO OBTAIN THIRD PARTY REIMBURSEMENT FOR THE PROCEDURES PERFORMED WITH OUR PRODUCTS.

If we obtain the necessary foreign regulatory registrations or approvals, market acceptance of our products in international markets would be dependent, in part, upon the availability of reimbursement within prevailing health care payment systems. Reimbursement is a significant factor considered by hospitals in determining whether to acquire new equipment. A hospital is more inclined to purchase new equipment if third-party reimbursement can be obtained. Reimbursement and health care payment systems in international markets vary significantly by country. They include both government sponsored health care and private insurance. Although we expect to seek international reimbursement

approvals, any such approvals may not be obtained in a timely manner, if at all. Failure to receive international reimbursement approvals could hurt market acceptance of TMR products in the international markets in which such approvals are sought, which would significantly reduce international revenue.

WE MAY ENGAGE IN FUTURE ACQUISITIONS THAT COULD DISTRACT OUR MANAGEMENT, CAUSE US TO INCUR DEBT, OR DILUTE OUR SHAREHOLDERS.

We may, from time to time, acquire or invest in other complementary businesses, products or technologies. While there are currently no commitments with respect to any particular acquisition or investment, our management frequently evaluates the strategic opportunities available in complementary businesses, products or technologies. The process of integrating an acquired company's business into our operations may result in unforeseen operating difficulties and expenditures and may absorb significant management attention that would otherwise be available for the ongoing development of our business. Moreover, the anticipated benefits of any acquisition or investment may not be realized. Any future acquisitions or investments by us could result in potentially dilutive issuances of equity securities, the incurrence of debt and contingent liabilities and amortization expenses related to goodwill and other intangible assets, any of which could materially harm our operating results.

THE PRICE OF OUR COMMON STOCK MAY FLUCTUATE SIGNIFICANTLY, WHICH MAY RESULT IN LOSSES FOR INVESTORS.

The market price for our common stock has been and may continue to be volatile. For example, during the 52-week period ended July 10, 2001, the closing prices of our common stock as reported on the NASDAQ National Market ranged from a high of $4.68 to a low of $0.50. We expect our stock price to be subject to fluctuations as a result of a variety of factors, including factors beyond our control. These factors include:

- actual or anticipated variations in our quarterly operating results;
- announcements of technological innovations or new products or services by us or our competitors;
- announcements relating to strategic relationships or acquisitions;
- changes in financial estimates by securities analysts;
- statements by securities analysts regarding us or our industry;
- conditions or trends in the medical device industry; and
- changes in the economic performance and/or market valuations of other medical device companies.

Because of this volatility, we may fail to meet the expectations of our shareholders or of securities analysts at some time in the future, and our stock price could decline as a result.

In addition, the stock market has experienced significant price and volume fluctuations that have particularly affected the trading prices of equity securities of many high technology companies. These fluctuations have often been unrelated or disproportionate to the operating performance of these companies. Any negative change in the public's perception of medical device companies could depress our stock price regardless of our operating results. If our common stock were to trade under $1.00 for 30 consecutive days on the NASDAQ National Market, our common stock could be subject to certain consequences established by the NASDAQ National Market such as being delisted.

Recently, when the market price of a stock has been volatile, holders of that stock have often instituted securities class action litigation against the company that issued the stock. If any of our shareholders brought such a lawsuit against us, we could incur substantial costs defending the lawsuit. The lawsuit could also divert the time and attention of our management.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Quantitative Disclosures

The Company is exposed to market risks inherent in its operations, primarily related to interest rate risk and currency risk. These risks arise from transactions and operations entered into in the normal course of business.

The Company does not use derivatives to alter the interest characteristics of its marketable securities or its debt instruments. The Company has no holdings of derivative or commodity instruments.

Interest Rate Risk. The Company is subject to interest rate risks on cash and cash equivalents and existing long-term debts and any future financing requirements. The long-term debt at December 31, 2000 consists of outstanding balances on a note payable and lease obligations.

The following table presents the future principal cash flows or amounts and related weighted average interest rates expected by year for the Company's existing cash and cash equivalents and long-term debt instruments:

IN THOUSANDS	2001	2002	2003	2004	2005	TOTAL FAIR VAL
Assets Cash, cash equivalents ..	$3,357	$ --	$ --	$ --	$ --	$ 3,35
Weighted average interest rate .	4.7%	--	--	--	--	4.
Liabilities Fixed Rate Debt Note payable	$ 86	$ --	$ --	$ --	$ --	$ 8
Weighted average interest rate .	8.0%	--	--	--	--	8.
Lease obligation	$ 32	$ 32	$ 32	$ --	$ --	$ 9
Weighted average interest rate .	6.8%	6.8%	6.8%	--	--	6.

Qualitative Disclosures

Interest Rate Risk. The Company's primary interest rate risk exposures relate to the impact of interest rate movements on the Company's ability to obtain adequate financing to fund future operations.

The Company manages interest rate risk on its outstanding long-term debts through the use of fixed rate debt. Management evaluates the Company's financial position on an ongoing basis.

The Company does not hedge any balance sheet exposures and intercompany balances against future movements in foreign exchange rates. The exposure related to currency rate movements would not have a material impact on future net income or cash flows.

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

See Item 14 below and the Index therein for a listing of the consolidated financial statements and supplementary data filed as part of this report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The following table and discussion sets forth certain information concerning our current directors. Certain of the information concerning our executive officers required by this Item is contained in the Section of Part I of our Annual Report on Form 10-K filed April 17, 2001 entitled "Item 1. Business --Employees."

NAME	AGE	POSITION
Michael J. Quinn....................	56	Chief Executive Officer, President, Chairman of the Board
Jack M. Gill, Ph.D.	65	Director
Alan L. Kaganov, Sc.D.	62	Director
Robert L. Mortensen (1)(2)	66	Director
Robert C. Strauss (1)(2)	59	Director

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(1) Member of the Audit Committee.
(2) Member of the Compensation Committee.

All directors hold office until the next annual meeting of shareholders or until their successors have been elected and qualified. Officers serve at the discretion of our Board of Directors and are appointed annually. There are no family relationships between any of our directors or officers.

Michael J. Quinn has served as our Chief Executive Officer, President and Chairman of the Board since October 2000. From 1978 to 1988, Mr. Quinn held senior operating management positions at the level of Vice President, Chief Operating Officer and President at major healthcare organizations including American Hospital Supply Corporation, Picker International, Cardinal Health Group, Bergen Brunswig and Fisher Scientific. Most recently Mr. Quinn served as President and Chief Executive Officer of Premier Laser Systems, a manufacturer of surgical and dental products. Prior to that position, he served as President of Imagyn Medical Technologies, a manufacturer of minimally invasive surgical specialty products.

Jack M. Gill, Ph.D. has been one of our directors since March 1999. Dr. Gill formerly served as Chairman of the Board of Directors of CardioGenesis Corporation from November 1993 to March 1999. Dr. Gill is a founding general partner of Vanguard Venture Partners and has served in such capacity since 1981. Dr. Gill is a director of a number of privately held medical device companies. Dr. Gill received his B.S. degree in Engineering from Lamar University and his Ph.D. in Organic Chemistry from Indiana University.

Alan L. Kaganov, Sc.D. has been one of our directors since January 1997. From December 1999 to October 2000, Dr. Kaganov served as Chief Executive Officer. Since July 1996, Dr. Kaganov has been a Venture Partner at U.S. Venture Partners. From May 1993 to June 1996, Dr. Kaganov was Vice President of Business Development and Strategic Planning at Boston Scientific Corporation. From June 1991 until December 1992 he was President and CEO of EP Technologies, a catheter-based electrophysiology company. Dr. Kaganov has a Masters and Doctorate of Science in biomedical engineering from Columbia University and an M.B.A. from New York University.

Robert L. Mortensen has been one of our directors since April 1992. Since 1984, Mr. Mortensen has been either President or Chairman of the Board and a director of Lightwave Electronics Corporation, a solid-state laser company that he founded. He holds an M.B.A. from Harvard University.

Robert C. Strauss has been one of our directors since March 1999. Mr. Strauss formerly served on the Board of Directors of CardioGenesis Corporation from December 1997 to March 1999. Mr. Strauss has served as President and Chief Executive Officer of Noven Pharmaceuticals, Inc. since December 1997. From March 1997 to July 1997, Mr. Strauss served as President and Chief Operating Officer of IVAX Corporation, a pharmaceutical company. In 1983, Mr. Strauss joined Cordis Corporation, a medical device company, as Chief Financial Officer. From February 1987 to February 1997, he served as President and Chief Executive Officer of Cordis Corporation

and in 1995, Mr. Strauss was named Chairman of the Board. Mr. Strauss serves on the board of trustees for the University of Miami and holds positions on the board of directors of Noven Pharmaceuticals, Columbia Laboratories, Inc., Percardia, Inc., and TissueLink Medical, Inc.. Mr. Strauss received his B.S. degree in Engineering Physics from the University of Illinois and his M.S. in Physics from the University of Idaho.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires our executive officers and directors, and persons who own more than ten percent of a registered class of our equity securities to file reports of ownership and changes in ownership with the Securities and Exchange Commission and the National Association of Securities Dealers, Inc. Executive officers, directors and greater-than-ten-percent shareholders are required by SEC regulation to furnish us with copies of all Section 16(a) forms they file. Based solely on our review of the copies of such forms received by us or written representations from certain reporting persons, we believe that, with respect to 2000, all of our executive officers, directors and ten percent shareholders complied with all applicable filing requirements, except for the following: Michael J. Quinn, Chief Executive Officer, filed a Form 3 twelve days late.

ITEM 11. EXECUTIVE COMPENSATION AND OTHER MATTERS.

The following table sets forth certain information concerning the annual and long-term compensation for services rendered in all capacities to CardioGenesis for the fiscal year 2000 by (i) all individuals who served at one point during 2000 as CardioGenesis' Chief Executive Officer, (ii) the four most highly compensated executive officers having compensation of $100,000 serving at the end of the fiscal year 2000, and (iii) two additional individuals who served as executive officers for CardioGenesis during the fiscal year 2000 but were not employed as executive officers at the end of the fiscal year 2000 (collectively, the "Named Executive Officers").

SUMMARY COMPENSATION TABLE

		ANNUAL COMPENSATION			LONG TERM COMPENSATION AWARDS	
NAME AND PRINCIPAL POSITION	FISCAL YEAR	SALARY ($)	BONUS ($)	OTHER ANNUAL COMPENSATION ($)	SECURITIES UNDERLYING OPTIONS/SAR (#)	ALL OT COMPENSA ($)
Michael J. Quinn(1)	2000	$66,000	--	$15,217(2)	700,000	
Chief Executive Officer	1999	--	--	--	--	
	1998	--	--	--	--	
Alan L. Kaganov(1)(3)	2000	7,500	--	--	7,500	
Former Chief Executive Officer	1999	15,000	--	--	157,500	
	1998	19,000	--	--	7,500	
Janet K. Castaneda(4)	2000	170,000	$26,300	--	25,000	
Former Vice President of Legal	1999	140,425	--	--	40,001	
Affairs	1998	132,500	12,825	--	9,999	
Ian A. Johnston	2000	137,000	--	--	30,000	
Vice President of Finance and	1999	105,594	20,000	--	30,000	
Treasurer	1998	--	--	--	--	
Richard P. Lanigan(5)	2000	170,000	24,600	--	50,000	

Vice President of Sales and Marketing	1999	134,458	--	--	33,000
	1998	105,528	10,398	--	15,500
Nancy Lince(4).......................	2000	162,000	34,800	--	30,000
Former Vice President of Regulatory	1999	105,398	20,000	--	44,500
and Clinical Affairs	1998	85,728	7,716	--	--
William E. Picht(6)..................	2000	135,088	32,700	--	--
Former Vice President of Operations	1999	204,909	--	--	30,000
	1998	181,500	16,335	--	15,000
Richard P. Powers(7).................	2000	170,000	34,800	--	--
Former Executive Vice President of	1999	219,248	36,765	--	79,280
Administration and Chief Financial Officer	1998	--	--	--	--

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(1) Effective as of October 16, 2000, Dr. Kaganov resigned as CardioGenesis' Chief Executive Officer and Mr. Quinn became our Chief Executive Officer, President and Chairman of the Board.

(2) Housing allowance and health insurance premiums.

(3) Dr. Kaganov received no salary as the Chief Executive Officer, but was paid for his services as one of our directors in 1998, 1999 and 2000.

(4) Ms. Castaneda and Ms. Lince are no longer employees of CardioGenesis.

(5) Effective March 2001, Mr. Lanigan became Vice President of Government Affairs and Business Development.

(6) Mr. Picht resigned on August 25, 2000.

(7) Mr. Powers resigned on July 18, 2000.

OPTION GRANTS IN FISCAL YEAR 2000

The following tables set forth information regarding stock options granted to and exercised by the Named Executive Officers during our fiscal year ended December 31, 2000.

OPTION GRANTS IN LAST FISCAL YEAR
INDIVIDUAL GRANTS(1)

NAME	NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED	% OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR	EXERCISE PRICE PER SHARE	EXPIRATION DATE	POTENTIAL REALIZABL VALUE AT ANNUAL RATES OF STOCK PRIC APPRECIATION FOR OPTION TERM(2) 5%	10%

Michael J. Quinn	700,000	45%	$ 1.688	10/17/10	$ 743,102	$1,883,1
Alan L. Kaganov, Sc.D. (3) .	7,500	--	$ 3.875	5/31/10	13,000	32,0
Janet K. Castaneda	25,000	2%	$ 1.375	11/28/10	21,618	54,7
Ian A. Johnston	5,000	0.3%	$ 4.00	7/11/10	12,578	31,8
	25,000	2%	$ 1.375	11/28/10	21,618	54,7
Richard P. Lanigan	25,000	2%	$ 6.563	4/11/10	57,373	188,5
	25,000	2%	$ 1.375	11/28/10	21,618	54,7
Nancy Lince	5,000	0.3%	$ 4.00	7/11/10	12,578	31,8
	25,000	2%	$ 1.375	11/28/10	21,618	31,8
William E. Picht	--	--	--	--	--	
Richard P. Powers	--	--	--	--	--	

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(1) Each of these options was granted pursuant to our Stock Option Plan. A total of 1,554,150 shares of Common Stock issuable upon exercise of options were granted to our employees in the year ended December 31, 2000.

(2) In accordance with the rules of the Securities and Exchange Commission, shown are the hypothetical gains or "option spreads" that would exist for the respective options. These gains are based on assumed rates of annual compounded stock price appreciation of 5% and 10% from the date the option was granted over the full option term. The 5% and 10% assumed rates of appreciation are mandated by the rules of the SEC and do not represent our estimate or projection of future increases in the price of our Common Stock.

(3) Dr. Kaganov was granted 7,500 stock options pursuant to our Director Stock Option Plan during the year ended December 31, 2000.

OPTIONS OUTSTANDING IN FISCAL YEAR 2000

The following table sets forth certain information for the year ended December 31, 2000 concerning exercised, exercisable and unexercisable stock options held by each of the Named Executive Officers.

AGGREGATE OPTION EXERCISES IN LAST FISCAL YEAR
AND FISCAL YEAR-END OPTION VALUES

	SHARES ACQUIRED ON EXERCISE(#)	VALUE REALIZED	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT FISCAL YEAR-END (#):		VALUE OF U IN-THE-MONE AT FISCAL YE	
			EXERCISABLE	UNEXERCISABLE	EXERCISABLE	U
Michael J. Quinn	--	--	38,889	661,111	--	
Alan L. Kaganov, Sc.D	--	--	372,500	--	--	
Janet K. Castaneda ..	--	--	58,053	46,947	--	
Ian A. Johnston	--	--	27,386	52,614	--	
Richard P. Lanigan ..	--	--	40,957	65,043	--	
Nancy Lince	--	--	20,305	54,487	--	
William E. Picht	--	--	--	--	--	
Richard P. Powers ...	--	--	186,653	43,346	--	

The value for an "in the money" option represents the difference between the exercise price of such option as determined by CardioGenesis' Board of Directors and the closing price of CardioGenesis' Common Stock on December 31, 2000 ($0.844), multiplied by the total number of shares subject to the option.

COMPENSATION OF DIRECTORS

For serving on the Board of Directors, directors who are not compensated as our employees or as consultants to us receive fees of $1,500 per board meeting and $1,500 per committee meeting, provided such committee meeting does not occur on the same day as a board meeting. We also have a Director Stock Option Plan for non-employee directors. In fiscal year 2000, directors Jack M. Gill, Robert C. Strauss, Alan L. Kaganov and Robert L. Mortensen were each granted an option to purchase an aggregate of 7,500 shares of Common Stock each upon re-election to our Board of Directors.

EMPLOYMENT CONTRACTS OF EXECUTIVE OFFICERS

Michael J. Quinn entered into a letter employment agreement with CardioGenesis effective October 16, 2000. The agreement provides for an annual salary of $330,000, subject to annual review and increase at the discretion of the Board of Directors and options to acquire 700,000 shares of CardioGenesis' Common Stock at an exercise price equal to $1.688 per share, which is the price of CardioGenesis' Common Stock on the date the option was granted. Mr. Quinn may also be entitled to receive (i) an annual bonus, the amount of which shall be determined by the Board of Directors and (ii) options or other rights to acquire CardioGenesis' Common Stock, under terms and conditions determined by the Compensation Committee of the Board of Directors. In the event of termination for any reason other than for "cause" or voluntary termination after the first year of employment, Mr. Quinn will receive salary paid as severance for six months. Mr. Quinn's letter employment agreement provides that his employment is "at will" at the discretion of CardioGenesis, and that he may be terminated at any time with or without notice and with or without cause.

Darrell F. Eckstein entered into a letter employment agreement with CardioGenesis effective December 19, 2000. The agreement provides for an annual salary of $225,000, subject to annual review and increase at the discretion of the Board of Directors and options to acquire 100,000 shares of CardioGenesis' Common Stock at an exercise price equal to $0.563 per share, which is the price of CardioGenesis' Common Stock on the date the option was granted. Mr. Eckstein may also be entitled to receive (i) an annual bonus, the amount of which shall be determined by the Board of Directors and (ii) options or other rights to acquire CardioGenesis' Common Stock, under terms and conditions determined by the Compensation Committee of the Board of Directors. In the event of a change of control of CardioGenesis, Mr. Eckstein will receive salary paid as severance for six months. Mr.

Eckstein's letter employment agreement provides that his employment is "at will" at the discretion of CardioGenesis, and that he may be terminated at any time with or without notice and with or without cause.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Compensation Committee of our Board of Directors for the year ended December 31, 2000 consisted of Robert L. Mortensen and Robert C. Strauss. No member of the Compensation Committee has a relationship that would constitute an interlocking relationship with executive officers or directors of another entity.

REPORT OF THE COMPENSATION COMMITTEE OF THE BOARD OF DIRECTORS

The following is the Report of the CardioGenesis Compensation Committee, describing the compensation policies and rationale applicable to our executive officers with respect to the compensation paid to such executive officers for the year ended December 31, 2000. The information contained in the report shall not be deemed to be "soliciting material" or to be "filed" with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933, as amended or the Securities Exchange Act of 1934, as amended, except to the extent that we specifically incorporate it by reference into such filing.

TO: Board of Directors

The Compensation Committee (the "Committee") of the Board of Directors reviews and approves CardioGenesis' executive compensation policies. The Committee administers CardioGenesis' various incentive plans, including the Stock Option Plan and the Employee Stock Purchase Plan, sets compensation policies applicable to CardioGenesis' executive officers and evaluates the performance of CardioGenesis' executive officers. The following is a report of the Committee describing compensation policies and rationale applicable with respect to the compensation paid to CardioGenesis' executive officers for the fiscal year ended December 31, 2000.

Two non-employee members of CardioGenesis' Board of Directors, Robert L. Mortensen and Robert C. Strauss, served as the Compensation Committee of the Board of Directors during 2000.

Compensation Philosophy

CardioGenesis' executive compensation programs are designed to attract, motivate and retain executives who will contribute significantly to the long-term success of CardioGenesis and the enhancement of shareholder value. In addition to base salary, certain elements of total compensation are payable in the form of variable incentive plans tied to the performance of CardioGenesis and the individual, and in the equity-based plans designed to closely align executive and shareholder interests.

Base Salary

Base salary for executives, including that of the chief executive officer, is set according to the responsibilities of the position, the specific skills and experience of the individual and the competitive market for executive talent. In order to evaluate the competitive position of CardioGenesis' salary structure, the Committee makes reference to publicly available compensation information and informal compensation surveys obtained by management with respect to cash compensation and stock option grants to officers of comparable companies in the high-technology sector, CardioGenesis' industry and its geographic location. Executive salary levels are set to approximate average rates, with the intent that superior performance under incentive bonus plans will enable the executive to elevate his total cash compensation levels that are above average of comparable companies. The Committee reviews salaries annually and adjusts them as appropriate to reflect changes in market conditions and individual performance and responsibilities.

Compensation to Chief Executive Officer in 2000

Pursuant to an employment agreement effective October 16, 2000, Mr. Michael Quinn, CardioGenesis' Chief Executive Officer, received base compensation at a rate of $330,000, or $66,000, during 2000.

Mr. Quinn's base salary was initially established by the Board of Directors. It was based on the Board's assessment that Mr. Quinn was uniquely qualified to lead CardioGenesis with his strong operational experience and history of accomplishments in the marketing and sales of products. The Board determined that his vision for CardioGenesis and his proven record of successful team building, would be pivotal to realizing the full potential of CardioGenesis.

Stock Option Plan

The Committee believes that CardioGenesis' Stock Option Plan is an essential tool to link the long-term interests of shareholders and employees, especially executive management, and serves to motivate executives to make decisions that will, in the long run, give the best returns to shareholders. Stock options are generally granted when an executive joins CardioGenesis, with subsequent grants also taking into account the individual's performance and the vesting status of previously granted options. These options typically vest over a three year period and are granted at an exercise price equal to the fair market value of CardioGenesis' Common Stock at the date of grant. The sizes of initial option grants are based upon the position, responsibilities and expected contribution of the individual. This approach is designed to maximize shareholder value over a long term, as no benefit is realized from the option grant unless the price of CardioGenesis' Common Stock has increased over a number of years.

In addition to the Stock Option Plan, executive officers are eligible to participate in CardioGenesis' Employee Stock Purchase Plan. This plan allows employees to purchase CardioGenesis' Common Stock at a price equal to 85% of the lower of the fair market value at the beginning of the offering period or the fair market value at the end of the purchase period.

Other elements of executive compensation include life and long-term disability insurance, medical benefits and a 401(k) deferred compensation plan with no employer matching contribution for the fiscal year ended December 31, 2000. All such benefits are available to all regular, full-time employees of CardioGenesis.

The foregoing report has been furnished by the Compensation Committee of the Board of Directors of CardioGenesis.

Compensation Committee

Robert L. Mortensen
Robert C. Strauss

STOCK PERFORMANCE GRAPH

The Stock Performance Graph below shall not be deemed "soliciting material" or to be "filed" with the Securities and Exchange Commission, nor shall such information be incorporated by reference in any general statement incorporating by reference this proxy statement into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that we specifically incorporate this information by reference.

The following Graph sets forth CardioGenesis' total cumulative shareholder return as compared to the Nasdaq Stock Market - Total Return Index (the "Nasdaq Total Return Index") and the Nasdaq Stock Market - Medical Devices, Instruments and Supplies, Manufacturers and Distributors Total Return Index (the "Nasdaq Medical Devices Index") from May 31, 1996 through December 31, 2000.

41

44

Total shareholder return assumes $100 was invested at the beginning of the period in the Common Stock of CardioGenesis, the stocks represented in the Nasdaq Total Return Index and the stocks represented in the Nasdaq Medical Devices Index, respectively. Total return also assumes reinvestment of dividends. CardioGenesis has paid no dividends on its Common Stock.

Historical stock price performance should not be relied upon as indicative of future stock price performance.

CARDIOGENESIS CORPORATION
NASDAQ STOCK MARKET -- TOTAL RETURN INDEX
NASDAQ STOCK MARKET - MEDICAL DEVICES INDEX

[CHART]

	5/31/96	12/31/96	12/31/97	12/31/98	12/31/99	12/31/00
CardioGenesis Corporation	$100.00	$ 53.03	$ 35.61	$ 44.32	$ 44.70	$ 5.12
NASDAQ Total Return Index	100.00	103.23	126.06	174.29	321.20	196.46
NASDAQ Medical Devices Index	100.00	86.65	99.19	111.12	134.40	138.46

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The following table sets forth as of March 31, 2001 (except as noted in the footnotes) certain information with respect to the beneficial ownership of our Common Stock by (i) each person known by us to own beneficially more than 5% of our outstanding shares of Common Stock; (ii) each of our directors; (iii) each of our current Named Executive Officers; and (iv) all directors and executive officers as a group. Except as indicated in the footnotes to this table, the persons and entities named in the table have sole voting and investment power with respect to all shares of Common Stock shown as beneficially owned by them, subject to community property laws where applicable.

NAME OF BENEFICIAL OWNER	SHARES OF COMMON STOCK BENEFICIALLY OWNED(1) NUMBER	PERCENTAGE OWNERSHIP
5% SHAREHOLDERS:		
Douglas Murphy-Chutorian, M.D(2) c/o MD DataDirect, Inc. 724 Oak Grove Avenue, Suite 120, Menlo Park, CA 94025	3,370,921	10.6%
Brown Capital Management, Inc. (3) 1201 North Calvert Street Baltimore, MD 21202	2,708,073	8.5%
State of Wisconsin Investment Board (4) 120 East Wilson Street Madison, WI 53703	4,088,000	12.9%
DIRECTORS:		
Jack M. Gill, Ph.D.(5)	1,201,325	3.8%
Alan L. Kaganov, Sc.D(6)	365,000	1.2%
Robert L. Mortensen(7)	95,196	*
Robert C. Strauss(8)	24,190	*
NAMED EXECUTIVE OFFICERS:		
Michael J. Quinn(9)(10)	166,110	*
Janet F. Castaneda(11)	63,609	*
Ian A. Johnston(12)	37,805	*
Richard P. Lanigan(13)	79,273	*
Nancy Lince(14)	25,818	*
William E. Picht	--	*
Richard P. Powers(15)	197,632	*
All directors and officers as a group (11 persons)(16)	2,255,958	7.1%

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* Less than 1%.

(1) Percentage ownership is based on 31,696,061 shares of Common Stock outstanding as of March 31, 2001. The number of shares of Common Stock beneficially owned or of record has been determined solely from information provided to CardioGenesis from the Douglas Murphy-Chutorian as of April 26, 2001. Includes an aggregate of 413,274 shares of Common Stock held by Leslie Murphy-Chutorian, the wife of Dr. Murphy-Chutorian, as custodian for Blair Murphy-Chutorian, UTMA California, an aggregate of 413,274 shares of Common Stock held by Leslie Murphy-Chutorian as custodian for Dana Murphy-Chutorian, UTMA California. Also includes an aggregate of 1,719,973 shares of Common Stock held by Leslie Murphy-Chutorian and Dr. Murphy-Chutorian as Trustees of The Murphy-Chutorian Family Trust UDT dated 1-13-97. Also includes 12,000 shares of Common Stock held by The Murphy Chutorian Family Foundation. Also includes 49,998 shares of Common Stock

subject to stock options held by Dr. Murphy-Chutorian that are exercisable within 60 days of March 31, 2001.

(3) The number of shares of Common Stock beneficially owned or of record has been determined solely from information reported on a Schedule 13G as of December 31, 2000.

(4) The number of shares of Common Stock beneficially owned or of record has been determined solely from information provided to CardioGenesis from the State of Wisconsin Investment Board as of April 11, 2001.

(5) Includes 23,507 shares of Common Stock subject to stock options held by Dr. Gill that are exercisable within 60 days of March 31, 2001.

(6) Includes 365,000 shares of Common Stock subject to stock options held by Dr. Kaganov that are exercisable within 60 days of March 31, 2001.

(7) Includes 95,196 shares of Common Stock subject to stock options held by Mr. Mortensen that are exercisable within 60 days of March 31, 2001.

(8) Includes 24,190 shares of Common Stock subject to stock options held by Mr. Strauss that are exercisable within 60 days of March 31, 2001.

(9) Michael J. Quinn is both a member of the Board of Directors and a Named Executive Officer in his positions as CardioGenesis' Chief Executive Officer, President and Chairman of the Board.

(10) Includes 136,110 shares of Common Stock subject to stock options held by Mr. Quinn that are exercisable within 60 days of March 31, 2001.

(11) Includes 63,609 shares of Common Stock subject to stock options held by Ms. Castaneda that are exercisable within 60 days of March 31, 2001.

(12) Includes 37,805 shares of Common Stock subject to stock options held by Mr. Johnston that are exercisable within 60 days of March 31, 2001.

(13) Includes 79,273 shares of Common Stock subject to stock options held by Mr. Lanigan that are exercisable within 60 days of March 31, 2001.

(14) Includes 25,818 shares of Common Stock subject to stock options held by Ms. Lince that are exercisable within 60 days of March 31, 2001.

(15) Includes 197,632 shares of Common Stock subject to stock options held by Mr. Powers that are exercisable within 60 days of March 31, 2001.

(16) Includes options to purchase an aggregate of 1,048,140 shares of Common Stock held by all officers and directors as a group exercisable within 60 days of March 31, 2001.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

In November 2000, CardioGenesis exercised warrants in MicroHeart Holdings, Inc. ("MicroHeart"), a Delaware company previously formed by U.S. Ventures and Venrock Associates, in exchange for common stock. This transaction resulted in an increase in CardioGenesis' ownership in Microheart to 32.1%. Dr. Alan Kaganov, former Chief Executive Officer and a current director of CardioGenesis is also a director of MicroHeart. Dr. Kaganov is also a Venture Partner of U.S. Venture Partners.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULE, AND REPORTS ON FORM 8-K.

(a)(1) FINANCIAL STATEMENTS. The financial statements required to be filed by Item 8 herewith are as follows:

PAGE

(2) FINANCIAL STATEMENT SCHEDULE.

The following financial statement schedule is filed herewith.

(3) EXHIBITS.

The exhibits listed under Item 14(c) are filed or incorporated by reference herein.

(b) REPORTS ON FORM 8-K.

We filed no reports on Form 8-K during the three month period ended December 31, 2000.

(c) EXHIBITS.

The exhibits below are filed or incorporated herein by reference.

EXHIBIT NUMBER	DESCRIPTION
2.1(2)	Agreement and Plan of Reorganization among the Company, the former CardioGenesis Corporation and RW Acquisition Corporation dated October 21, 1998.
3.1(2)	Certificate of Amendment and Restated Articles of Incorporation of Registrant.
3.2(2)	Amended and Restated Bylaws of Registrant.
10.1(2)	Form of Director and Officer Indemnification Agreement.
10.2(2)	Stock Option Plan.
10.3(2)	Director Stock Option Plan.
10.4(2)	1996 Employee Stock Purchase Plan.
10.5(2)	Facilities Lease for 1049 Kiel Court, Sunnyvale, California.
10.6(2)	Facilities Lease for 1139 Karlstad Drive, Sunnyvale,

	California.
10.7(2)	401(k) Plan.
10.8(3)	1993 Equity Incentive Plan of the former CardioGenesis Corporation
10.9(3)	1996 Directors Stock Option Plan of the former CardioGenesis Corporation
10.10(3)	1996 Employee Stock Purchase Plan of the former CardioGenesis Corporation
10.11(4)	1996 Equity Incentive Plan of the former CardioGenesis Corporation
10.12*	Letter employment agreement dated October 16, 2000 between the Company and Michael J. Quinn, Chief Executive Officer.
10.13*	Letter employment agreement dated December 19, 2000 between the company and Darrell F. Eckstein, Vice President of Operations.
21.1*	List of Subsidiaries
23.1	Consent of PricewaterhouseCoopers LLP
24.1*	Power of Attorney (see page 34)

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(1) Incorporated herein by reference to Appendix 1 to the Company's Registration Statement on S-4 filed with the Securities and Exchange Commission on February 9, 1999 (File No. 333-72063).

(2) Incorporated herein by reference from the Company's Registration Statement on Form S-1 (File No. 333-03770), as amended, filed on April 18, 1996.

(3) Incorporated herein by reference from the former CardioGenesis Corporation's Form SB-2, (File No. 333-3752-LA), declared effective on May 21, 1996.

(4) Incorporated herein by reference from the former CardioGenesis Corporation's Form S-8, (File No. 333-35095, dated September 8, 1997).

* Previously filed.

SIGNATURES

PURSUANT TO THE REQUIREMENTS OF SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934, THE REGISTRANT HAS DULY CAUSED THIS REPORT TO BE SIGNED ON ITS BEHALF BY THE UNDERSIGNED, THEREUNTO DULY AUTHORIZED.

CARDIOGENESIS CORPORATION
Registrant

Date: July 13, 2001

By: /s/ Michael J. Quinn

Michael J. Quinn
Chief Executive Officer, President,
Chairman of the Board and Director
(Principal Executive Officer)

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934, THIS REPORT HAS BEEN SIGNED BELOW BY THE FOLLOWING PERSONS ON BEHALF OF THE REGISTRANT IN THE CAPACITIES AND ON THE DATE INDICATED.

SIGNATURE	TITLE	DATE
/s/ MICHAEL J. QUINN Michael J. Quinn	Chief Executive Officer, President, Chairman of the Board and Director (Principal Executive Officer)	July 13, 2001
/s/ J. STEPHEN WILKINS J. Stephen Wilkins	Chief Financial Officer (Principal Accounting and Financial Officer)	July 13, 2001
* Alan L. Kaganov, Sc.D.	Director	July 13, 2001
* Jack M. Gill	Director	July 13, 2001
* Robert L. Mortensen	Director	July 13, 2001
* Robert C. Strauss	Director	July 13, 2001

* BY:/s/ Michael J. Quinn — Attorney-in-Fact

Michael J. Quinn
President and Chief Executive Officer

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders of
Eclipse Surgical Technologies, Inc.

In our opinion, the consolidated financial statements listed in the index appearing under Item 14(a)(1) on page 32 present fairly, in all material respects, the financial position of Eclipse Surgical Technologies, Inc. and its subsidiaries (the "Company") at December 31, 2000 and December 31, 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 14(a)(2) on page 32 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and the financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP
San Jose, California
January 26, 2001, except Note 18
as to which the date is April 16, 2001

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ECLIPSE SURGICAL TECHNOLOGIES, INC.

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2000 AND 1999
(IN THOUSANDS)

ASSETS	2000	1999
Current assets:		
Cash and cash equivalents	$ 3,357	$ 5,566
Marketable securities	--	3,227
Accounts receivable, net of allowance for doubtful accounts of $353 and $1,079 at December 31, 2000 and 1999, respectively	3,654	8,119
Inventories, net of reserve of $2,180 and $1,998 at December 31, 2000 and 1999, respectively	5,400	6,983
Prepaids and other current assets	837	767
Total current assets	13,248	24,662
Property and equipment, net	1,048	1,220
Long-term marketable securities	--	4,520
Accounts receivable over one year, net of allowance for doubtful accounts of $443 and $797, at December 31, 2000 and 1999,		

respectively	119	1,125
Other assets	2,550	2,492
Total assets	$ 16,965	$ 34,019
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 689	$ 1,819
Accrued liabilities	5,789	9,557
Customer deposits	186	145
Deferred revenue	1,310	1,720
Note payable	86	--
Current portion of capital lease obligation	26	26
Current portion of long-term liabilities	500	1,364
Total current liabilities	8,586	14,631
Capital lease obligation, less current portion	66	90
Long-term liabilities, less current portion	339	725
Total liabilities	8,991	15,446
Commitments and contingencies (Note 11)		
Shareholders' equity:		
Preferred stock: no par value; 6,600 shares authorized; none issued and outstanding;	--	--
Common stock: no par value; 50,000 shares authorized; 30,836 and 29,437 shares issued and outstanding at December 31, 2000 and 1999, respectively	161,938	158,338
Deferred compensation	(66)	(466)
Accumulated other comprehensive loss	(65)	(75)
Accumulated deficit	(153,833)	(139,224)
Total shareholders' equity	7,974	18,573
Total liabilities and shareholders' equity	$ 16,965	$ 34,019

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

ECLIPSE SURGICAL TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	2000	1999	1998

Net revenues	$ 22,210	$ 25,324	$ 15,080
Cost of revenues(1)	10,055	13,246	7,868
Gross profit	12,155	12,078	7,212
Operating expenses:			
Research and development	5,065	11,353	29,861
Sales and marketing	15,349	16,553	17,663
General and administrative	6,660	8,028	10,821
Merger-related costs	--	5,214	--
Total operating expenses	27,074	41,148	58,345
Operating loss	(14,919)	(29,070)	(51,133)
Interest expense	(32)	(64)	(88)
Interest and other income	400	801	3,454
Equity in net loss of investee	(58)	--	--
Net loss	(14,609)	(28,333)	(47,767)
Other comprehensive income (loss), net of tax:			
Unrealized gains (losses) on securities:			
Unrealized holding gains (losses) arising during period	44	(145)	38
Less: reclassification adjustment for gains included in net Income	--	(5)	(50)
Foreign currency translation adjustment	(34)	26	3
Other comprehensive income (loss)	10	(124)	(9)
Comprehensive loss	$(14,599)	$(28,457)	$(47,776)
Net loss per share:			
Basic and diluted	$ (0.48)	$ (0.99)	$ (1.77)
Weighted average shares outstanding	30,166	28,629	27,000

(1) Fiscal year 1999 includes $2,523 of inventory write-offs and a laser upgrade program resulting from the merger - Note 3

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

ECLIPSE SURGICAL TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT)
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998
(IN THOUSANDS)

ACCUMULATED

	COMMON STOCK SHARES(#)	COMMON STOCK AMOUNT	DEFERRED COMPENSATION	OTHER COMPREHENSIVE INCOME (LOSS)
Balances, December 31, 1997	26,511	$ 146,288	$ (848)	$ 58
Issuance of common stock pursuant to exercise of options	650	1,496	--	--
Issuance of common stock pursuant to exercise of warrants	305	725	--	--
Deferred stock compensation	--	438	(438)	--
Amortization of deferred compensation	--	--	457	--
Net change in unrealized gain on marketable securities	--	--	--	(12)
Foreign currency translation adjustment	--	--	--	3
Net loss	--	--	--	--
Balances, December 31, 1998	27,466	148,947	(829)	49
Issuance of common stock pursuant to exercise of options	1,522	7,747	--	--
Issuance of common stock pursuant to exercise of warrants	449	833	--	--
Deferred stock compensation	--	811	(811)	--
Amortization of deferred compensation	--	--	1,174	--
Net change in unrealized gain on marketable securities	--	--	--	(150)
Foreign currency translation adjustment	--	--	--	26
Net loss	--	--	--	--
Balances, December 31, 1999	29,437	158,338	(466)	(75)
Issuance of common stock pursuant to exercise of options	640	1,064	--	--
Issuance of common stock pursuant to stock purchase under the Employee Stock Purchase Plan	204	388	--	--
Issuance of common stock in a private replacement	526	1,873	--	--
Issuance of common stock in lieu of payment for services	29	44	--	--
Deferred stock compensation	--	231	(231)	--
Amortization of deferred compensation	--	--	631	--
Net change in unrealized gain on marketable securities	--	--	--	44
Foreign currency translation adjustment	--	--	--	(34)
Net loss	--	--	--	--
Balances, December 31, 2000	30,836	$ 161,938	$ (66)	$ (65)

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

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ECLIPSE SURGICAL TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998
(IN THOUSANDS)

	2000	1999
Cash flows from operating activities:		
Net loss	$(14,609)	$(28,333
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	933	1,453
Loss/(gain) from investment in MicroHeart Holdings, Inc.	58	--
Provision for doubtful accounts	620	1,377
Inventory reserves	1,788	1,782
Amortization of deferred compensation	631	1,174
Amortization of license fees	194	195
Loss on disposal of property and equipment	--	317
Issuance of stock to private company in lieu of payment for services	44	--
Changes in operating assets and liabilities:		
Accounts receivable -- short term	3,756	551
Inventories	(694)	799
Prepaids and other current assets	(70)	1,195
Other assets	--	24
Accounts receivable -- long term	1,096	51
Accounts payable	(1,130)	230
Accrued liabilities	(3,768)	(1,907
Current portion of long term liabilities	(375)	--
Long term liabilities	(386)	(687
Customer deposits	41	(111
Deferred revenue	(410)	(425
Net cash used in operating activities	(12,281)	(22,315
Cash flows from investing activities:		
Purchase of marketable securities	(3,317)	(44,702
Maturities of marketable securities	11,108	61,473
Acquisition of property and equipment	(762)	(637
Exercise of warrants in Microheart Holdings, Inc.	(310)	--
Net cash provided by investing activities	6,719	16,134
Cash flows from financing activities:		
Net proceeds from issuance of common stock from exercise of options and warrants	1,452	8,580
Net proceeds from sale of common stock	1,873	--
Proceeds from short term borrowings	86	--
Repayment of note payable	--	(111
Repayments of capital lease obligations	(24)	(21

Net cash provided by financing activities	3,387	8,448
Effects of exchange rate changes on cash and cash equivalents	(34)	26
Net increase (decrease) in cash and cash equivalents	(2,209)	2,293
Cash and cash equivalents at beginning of year	5,566	3,273
Cash and cash equivalents at end of year	$ 3,357	$ 5,566
Supplemental schedule of cash flow information:		
Interest paid	$ 32	$ 64
Taxes paid	$ 153	$ 112
Supplemental schedule of noncash investing and financing activities:		
Change in unrealized gain (loss) on marketable securities	$ 44	$ (150
Investment in MicroHeart Holdings, Inc.	$ --	$ --
Deferred compensation	$ 231	$ 811
Acquisition of equipment under capital leases	$ --	$ --

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

ECLIPSE SURGICAL TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS:

Eclipse Surgical Technologies, Inc. ("Eclipse" or the "Company") was founded in 1989 to develop, manufacture and market surgical lasers and accessories for the treatment of disease. Currently, Eclipse's emphasis is on the development and manufacture of products used for transmyocardial revascularization ("TMR") and percutaneous transluminal myocardial revascularization ("PTMR"), which are cardiovascular procedures. Eclipse markets its products for sale primarily in the U.S., Europe and Asia. Eclipse operates in a single segment.

These financial statements contemplate the realization of assets and the satisfaction of liabilities in the normal course of business. Eclipse has sustained significant losses for the last several years and expects to continue to incur losses through at least 2001. Management believes its cash balance as of December 31, 2001 will not be sufficient to meet the Company's capital and operating requirements for the next 12 months. Eclipse will require additional funding and may sell additional shares of its common stock or preferred stock through private placement of further public offerings or debt financings. (see Note 18).

Eclipse may require additional financing in the future. There can be no assurance that Eclipse will be able to obtain additional debt or equity financing, if and when needed, on terms acceptable to the Company. Any additional equity or debt financing may involve substantial dilution to Eclipse's stockholder, restrictive covenants or high interest costs. The failure to raise needed funds on sufficiently favorable terms could have a material adverse effect on Eclipse's business, operating results and financial condition.

Eclipse's long term liquidity also depends upon its ability to increase revenues from the sale of its products and achieve profitability. The failure to achieve these goals could have a material adverse effect on the business, operating results and financial condition.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation:

On March 17, 1999, Eclipse completed the acquisition of CardioGenesis Corporation (CardioGenesis) pursuant to the Agreement and Plan of Reorganization (the "merger') dated as of October 21, 1998. The merger was accounted for using the pooling of interests method of accounting for business combinations. Accordingly, Eclipse's financial statements have been restated to include the accounts of CardioGenesis for the years 1998 and 1999. The accompanying consolidated financial statements include the accounts of Eclipse (and CardioGenesis) and its then wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated.

Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassification:

The Company has reclassified $2,523,000 from merger-related costs to cost of revenues for the year ended December 31, 1999 for inventory write-offs and a laser upgrade program related to the merger. The

reclassification was made to ensure that the Company's merger costs are in compliance with the appropriate accounting rules and interpretations.

Cash and Cash Equivalents:

All highly liquid instruments purchased with an original maturity of three months or less are considered cash equivalents.

Marketable Securities:

Marketable securities are classified as available-for-sale and are carried at fair value. Marketable securities classified as current assets have scheduled maturities of less than one year, while marketable securities classified as noncurrent assets have scheduled maturities of more than one year. Unrealized holding gains or losses on such securities are included in accumulated comprehensive income/(loss) in shareholders' equity. Realized gains and losses on sales of all such securities are reported in earnings and computed using the specific identification cost method.

Inventories:

Inventories are stated at the lower of cost (principally standard cost, which approximates actual cost on a first-in, first-out basis) or market value.

Patent Expenses:

Patent and patent related expenditures are expensed as general and administrative expenses as incurred.

Property and Equipment:

Property and equipment are stated at cost and depreciated on a straight-line basis over their estimated useful lives of two to seven years. Assets acquired under capital leases are amortized over the shorter of their estimated useful lives or the term of the related lease (generally three to five years). Amortization of leasehold improvements is based on the straight-line method over the shorter of the estimated useful life or the lease term.

Long-Lived Assets:

Eclipse evaluates the recoverability of its long-lived assets in accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" ("SFAS 121"). SFAS 121 requires recognition of the impairment of long-lived assets in the event the net book value of such assets exceeds the future undiscounted cash flows attributable to such assets.

Fair Value of Financial Instruments:

The carrying amounts of certain of Eclipse's financial instruments including cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and customer deposits approximate fair value due to their short maturities.

Certain Risks and Concentrations:

Eclipse sells its products primarily to hospitals and other healthcare providers in North America, Europe and Asia. Eclipse performs ongoing credit evaluations of its customers and generally does not require collateral. Although Eclipse maintains allowances for potential credit losses that it believes to be adequate, a payment default

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

on a significant sale could materially and adversely affect its operating results and financial condition. At years ending December 31, 2000, December 31, 1999 and December 31, 1998 no customer individually accounted for 10% or more of accounts receivable, nor did any customer individually account for 10% or more of net revenues for the years ended December 31, 2000, December 31, 1999 or December 31, 1998.

Eclipse purchases certain laser and fiber-optic components and subassemblies from single sources. Although Eclipse has identified alternative vendors, the qualification of additional or replacement vendors for certain components or services is a lengthy process. Any significant supply interruption could affect Eclipse's ability to manufacture its products and would, therefore, adversely affect operating results.

Revenue Recognition:

Eclipse has adopted the provisions of Staff Accounting Bulletin ("SAB") No. 101 "Revenue Recognition in Financial Statements" and believes that its current and historical revenue recognition is in compliance with the SAB.

Eclipse recognizes revenue on product sales upon receipt of a purchase order, subsequent shipment of the product and the price is fixed or determinable and collection of sales proceeds is reasonably assured. Where purchase orders allow customers an acceptance period or other contingencies, revenue is recognized upon the earlier of acceptance or removal of the contingency.

Revenues from sales to distributors and agents are recognized upon shipment when there is evidence that an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility of sales proceeds is reasonably assured. The contracts regarding these sales do not include any rights of return or price protection clauses.

Eclipse frequently loans lasers to hospitals in return for the hospital purchasing a minimum number of handpieces at a premium over the list price. The loaned lasers are depreciated to costs of revenues over a useful life of 24 months. The revenue on the handpieces is recognized upon shipment at an amount equal to the list price. The premium over the list price represents revenue related to the use of the laser unit and is recognized ratably, generally over the 24 month useful life of the placed lasers.

Revenues from service contracts, rentals, and per procedure fees are recognized upon performance or over the terms of the contract as appropriate.

Research and Development:

Research and development expenses are charged to operations as incurred.

Warranties:

Eclipse's laser products are generally warranted for one year. Eclipse provides for estimated future costs of repair, replacement, or customer accommodations which are reflected in the accompanying financial statements.

Advertising:

Eclipse expenses all advertising as incurred. Eclipse's advertising expenses were $128,000, $75,000, and $18,000 for 2000, 1999 and 1998, respectively.

ECLIPSE SURGICAL TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Income Taxes:

Eclipse accounts for income taxes using the liability method under which deferred tax assets or liabilities are calculated at the balance sheet date using current tax laws and rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amounts expected to be realized.

Foreign Currency Translation:

Eclipse's international subsidiary uses its local currency as its functional currency. Assets and liabilities are translated at exchange rates in effect at the balance sheet date and income and expense accounts at average exchange rates during the year. Resulting translation adjustments are recorded in accumulated other comprehensive income/loss in shareholders' equity. Transaction gains and losses are included in the results of operations and have not been significant for all periods presented.

Stock-Based Compensation:

Eclipse accounts for its stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Eclipse has elected to adopt the disclosure only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), which requires pro forma disclosures in the financial statements as if the measurement provisions of SFAS 123 had been adopted.

Eclipse accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS 123 and Emerging Issues Task Force Issue No. 96-18 "Accounting for Equity Instruments that are issued to other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services."

Net Loss Per Share:

Basic earnings per share ("EPS") is computed by dividing the net loss available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS is computed giving effect to all dilutive potential common shares that were outstanding during the period. Dilutive potential common shares consist of incremental shares issuable upon the conversion of convertible preferred stock (using the "if converted" method) and the exercise of stock options and warrants (using the "treasury stock" method).

A reconciliation of the numerator and denominator of basic and diluted EPS is as follows (in thousands, except per share amounts):

	YEAR ENDED DECEMBER 31,		
	2000	1999	1998
Numerator -- Basic and Diluted EPS			
Net Loss.............................	$(14,609)	$(28,333)	$(47,767)
Denominator -- Basic and Diluted EPS			
Weighted average shares outstanding...	30,166	28,629	27,000
Basic and diluted EPS.................	$ (0.48)	$ (0.99)	$ (1.77)

Options to purchase 4,277,021, 4,381,335, and 4,533,000 shares of common stock were outstanding at December 31, 2000, 1999 and 1998, respectively. The range of exercise prices for these options were $0.03-$15.9375 for 2000, $0.03-$16.09 for 1999 and $0.03-$18.125 for 1998. No warrants were outstanding at December 31, 2000 and 1999. Warrants to purchase 466,123 shares of common stock were outstanding as of

ECLIPSE SURGICAL TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 1998. Both the options and warrants were not included in the calculation of diluted EPS because their inclusion would have been anti-dilutive.

Recent Accounting Pronouncements:

In June 1998, the Financial Accounting Standards Board issued SFAS 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS 133 establishes new standards of accounting and reporting for derivative instruments and hedging activities. SFAS 133 requires that all derivatives be recognized at fair value in the statement of financial position, and that the corresponding gains or losses be reported either in the statement of operations or as a component of comprehensive income, depending on the type of hedging relationship that exists. Eclipse does not currently hold derivative instruments or engage in hedging activities. Eclipse will adopt SFAS 133 in the first quarter of 2001 and does not believe that the initial adoption will have a material impact on the Company's financial statements.

3. BUSINESS COMBINATION

On March 17, 1999, Eclipse and CardioGenesis Corporation ("CardioGenesis") announced the completion of their business combination. Under the terms of the combination, each share of CardioGenesis Common Stock was converted into 0.8 of a share of Eclipse Common Stock, and Eclipse assumed all outstanding CardioGenesis stock options. CardioGenesis became a wholly-owned subsidiary of Eclipse and its shares are no longer publicly traded. As a result of the transaction, Eclipse increased its outstanding shares by approximately 9.9 million shares. The transaction was structured to qualify as a tax-free reorganization and was accounted for as a pooling of interests, consequently, all prior period figures have been restated as if the combined entity existed for all periods presented. There were no inter-company transactions between the companies prior to the date of the business combination. The fiscal year remained the same and thus, there were no changes in retained earnings due to the business combination. Further, there were no required adjustments needed to conform to the accounting policies between the two companies.

CardioGenesis was a medical device company like Eclipse which developed, manufactured, and marketed cardiac revascularization products for the treatment of advanced cardiovascular disease and severe angina pain through TMR and PTMR. CardioGenesis also manufactured and marketed disposable products to perform intraoperative transmyocardial revascularization ("ITMR"), catheter-based percutaneous myocardial revascularization ("PMR"), and thorascopic transmyocardial revascularization ("TTMR") to treat patients afflicted with debilitating angina. During the quarter ended March 31, 1999, Eclipse recognized merger-related costs of $6,893,000 for financial advisory and legal fees, personnel severance, terminated relationships and other costs including write-offs of fixed assets and inventory. A majority of the terminated employees were located in California and worked in operations, sales, marketing, quality, research and development and administrative functions. A total of 40 employees were terminated.

During the remaining quarters ended December 31, 1999, Eclipse recognized additional merger-related costs of $1,385,000 offset by a reversal of $541,000, as costs associated with terminated relationships/contracts were lower than anticipated. The total of merger-related cost of $7,737; this includes inventory write-offs and a laser upgrade program totaling $2,523,000 that is accounted for in our cost of revenues.

The inventory and upgrade program write-off of $2,523,000 consisted of three primary components. The first includes inventory for domestic product that was written-off in full at the time of the merger since the CardioGenesis laser platform was not approved by the FDA and thus abandoned in favor of the FDA approved Eclipse TMR2000 laser platform. Approximately, $350,000 was written-off for CardioGenesis lasers on loan in the United States in addition to $600,000 of raw materials inventory components used for domestic laser assembly. CardioGenesis' relationship with their laser vendor was terminated at the time of the merger, so any

raw material remaining could not be returned or utilized to build additional lasers. The second type of inventory that was written-off in full at the time of the merger was approximately $400,000 of Eclipse laser parts for lasers in clinical trials abandoned in favor of future CardioGenesis products. Lastly, $1,100,000 of the write-off was the result of an upgrade program where Eclipse would replace lasers made obsolete by the decision to abandon certain platforms to customers who previously paid for their system. This amount was accrued over the course of 1999 as these systems were identified, and later applied to the cost of the laser when the upgrade was shipped out to the customer.

As a result of the merger, various assets were determined to no longer have recognizable value and were written off completely. Of the lasers used internally at CardioGenesis, $118,000 were no longer useful post merger given the decision to make the Eclipse TMR2000 laser system the platform of choice. We recorded $118,000 of loss on disposal of assets and classified the expense as merger-related cost. Of the remaining asset value for all leasehold improvements to CardioGenesis' Oakmead facility, $117,0000 was also written off, as that facility was vacated at the time of the merger. Lastly, the two companies utilized different manufacturing and accounting software prior to the merger, so the $35,000 remaining net value of the software used by CardioGenesis prior to the merger was written off, in full as it was no longer going to be utilized. We recorded $35,000 of loss on disposal of the manufacturing and accounting software and classified the expense as merger-related cost.

The following table summarizes the merger-related costs (in thousands).

DESCRIPTION	AMOUNT
Financial advisory and legal fees	$ 2,528
Personnel severance	1,190
Terminated relationships/contracts	910
Other costs including fixed asset and inventory write-offs	3,109
Subtotal	$ 7,737
Less: Amount included in cost of revenues	(2,523)
Total	$ 5,214

ECLIPSE SURGICAL TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table summarizes the Company's merger related reserve balances (in thousands):

Merger-related costs	$ 7,737
Non-cash charges	(2,060)
Cash payments	(5,407)
Merger reserve balance at December 31, 2000	$ 270

The merger reserve balance is included in accrued liabilities.

The following table summarizes the combined operating results of Eclipse and CardioGenesis as if the merger had occurred at the beginning of the periods presented:

	FOR THE YEARS ENDED DECEMBER 31, 1998	1997
Revenue:		
Eclipse previously reported	$ 12,002	$ 5,499
CardioGenesis	$ 3,078	$ 7,559
Restated Revenue	$ 15,080	$ 13,058
Net loss:		
Eclipse previously reported	$(20,354)	$(18,247)
CardioGenesis	$(27,413)	$(17,971)
Restated net loss	$(47,767)	$(36,218)
Basic and diluted net loss per share:		
Eclipse previously reported	$ (1.18)	$ (1.11)
CardioGenesis	$ (2.80)	$ (1.49)
Restated basic and diluted net loss per share	$ (1.77)	$ (1.39)

The earnings per common share are based on the sum of historical average common shares outstanding, as reported by Eclipse, and the historical average common shares outstanding for CardioGenesis (adjusted for the exchange ratio).

The following table summarizes the fiscal year 1999 revenues and net income of Eclipse and CardioGenesis through 3/31/99:

	QUARTER ENDED MARCH 31, 1999
CardioGenesis:	
Revenues..................................	$ 675
Net Income................................	$(8,317)
Eclipse:	
Revenues..................................	$ 3,799
Net Income................................	$(6,849)

ECLIPSE SURGICAL TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table summarizes the Company's merger related reserve balances (in thousands):

Merger Related Cost (for the twelve month period ended December 31, 1999)	$ 8,278
Less:	
Change in estimate................................	541
Non-cash charges................................	2,060
Cash payments....................................	5,163
Merger Reserve balance at December 31, 1999	$ 514
Less:	
Cash payments....................................	244
Merger Reserve balance at December 31, 2000	$ 270

4. INVESTMENT IN UNCONSOLIDATED AFFILIATE, AT EQUITY:

At December 31, 2000, Eclipse had a 32.1% ownership interest in MicroHeart Holdings, Inc., "MicroHeart", which is accounted for under the equity method. The investment in MicroHeart is recorded at cost and adjusted for the Company's share of the income/(loss) of the investment. As of December 31, 2000, Eclipse recorded net loss of $58,000, which represents Eclipse's equity in the loss incurred by MicroHeart subsequent to obtaining the equity interest. Eclipse recorded no income or loss related to MicroHeart under the equity method in 1999 or 1998.

5. MARKETABLE SECURITIES:

At December 31, 2000, Eclipse held no marketable securities. At December 31, 1999, marketable securities had a cost basis of approximately $7,649,000 and a fair value of $7,747,000.

6. INVENTORIES:

Inventories consist of the following (in thousands):

	DECEMBER 31, 2000	DECEMBER 31, 1999
Raw materials	$2,045	$3,074
Work in process ...	715	624
Finished goods	2,640	3,285
	$5,400	$6,983

7. PROPERTY AND EQUIPMENT:

Property and equipment consists of the following (in thousands):

	DECEMBER 31, 2000	DECEMBER 31, 1999
Computers and equipment	$ 2,508	$ 2,262
Manufacturing and demonstration equipment	2,216	2,119
Assets in progress	183	6
Leasehold improvements	198	242
	5,105	4,627
Less accumulated depreciation and amortization	(4,057)	(3,407)
	$ 1,048	$ 1,220

ECLIPSE SURGICAL TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Eclipse leases certain equipment under a capital lease which expires in December 2003. Accordingly, capitalized costs of $138,000, net of accumulated amortization of $57,000, are included in computers and equipment at December 31, 2000.

8. ACCRUED LIABILITIES:

Accrued liabilities consists of the following (in thousands):

	DECEMBER 31, 2000	DECEMBER 31, 1999
Accrued research support	$2,356	$2,918
Accrued accounts payable and related expenses	1,256	354
Accrued merger expenses	270	514
Accrued withholdings on exercised options ...	74	2,031
Accrued salaries and related expenses	472	1,206
Accrued commissions	235	468
Accrued consulting fees and related expenses	43	40
Accrued warranty	158	225
Accrued legal expense	30	262
Accrued other	895	1,539
	$5,789	$9,557

9. NOTE PAYABLE:

In May 2000, Eclipse financed insurance premiums for Directors & Officers insurance with a $319,000 note payable to a finance company at 8.0% per annum, with an outstanding balance of $86,000 at December 31, 2000. At December 31, 1999, there were no outstanding note payable balances.

10. LONG-TERM LIABILITIES:

On January 5, 1999, prior to the merger with Eclipse, CardioGenesis entered into a Settlement and License Agreement with PLC Medical Systems, Inc. (PLC) which grants CardioGenesis a non-exclusive worldwide license to certain PLC patents. In return, CardioGenesis agreed to pay PLC a license fee and minimum royalties totaling $2.5 million over an approximately forty-month period. The present value of these payments of $2.3 million has been recorded as a prepaid license fee in other assets, and is being amortized over the life of the underlying patents. The liability for outstanding payments due to PLC is reflected in the current and long term portions of long-term liabilities and payable as follows (in thousands):

Year Ending December 31,	
2001....................................	$ 500
2002....................................	375
	875
Less: Amount representing interest.......	(36)
Present value of long-term liabilities...	839
Less: Current portion...................	(500)
Long-term portion.......................	$ 339

ECLIPSE SURGICAL TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

11. COMMITMENTS AND CONTINGENCIES:

Eclipse has entered into three operating leases for office facilities with terms extending through September 2002. The minimum future rental payments are as follows (in thousands):

Year Ending December 31,	
2001....................................	$ 991
2002....................................	715

$1,706
======

Rent expense was approximately $950,000, $1,089,000 and $883,000 for the years ended December 31, 2000, 1999 and 1998, respectively.

At December 31, 2000 the Company held a capital lease which bears interest at 6.8% and expires in December 2003. Future minimum lease payments under this capital lease are as follows (in thousands):

Year Ending December 31,	
2001	$ 32
2002	32
2003	32

Total minimum lease payments	96
Less: Amount representing interest	(4)

Present value of capital lease obligations	92
Less: Current portion	(26)

Long-term portion of capital lease obligations	$ 66
	====

Eclipse is engaged in certain legal and administrative proceedings incidental to its normal business activities. While it is not possible to determine the ultimate outcome of these actions at this time, management believes that any liabilities resulting from such proceedings, or claims which are pending or known to be threatened, will not have a material adverse effect on the Company's financial position, cash flows or results of operations.

12. SHAREHOLDERS' EQUITY:

Warrants:

At December 31, 2000, there were no warrants outstanding. During the years ended December 31, 2000, 1999 and 1998, none, 448,799, and 304,715 warrants were exercised, respectively, generating proceeds of approximately none, $833,000, and $725,000 respectively.

Options Granted to Consultants:

At December 31, 2000, options for consultants to purchase a total of 371,000 shares of common stock at exercise prices ranging from $4.00 to $8.75 per share were outstanding. The exercisability and termination of this plan is the same as Eclipse's Stock Option Plan which is described below. At December 31, 2000, Eclipse had reserved 371,000 shares of common stock for issuance upon exercise of these options. Eclipse recorded deferred stock compensation of $231,000 in 2000 related to these options. These options are included in the Stock Option Plan disclosures below.

ECLIPSE SURGICAL TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Stock Option Plan:

Eclipse maintains a Stock Option Plan, which includes the Employee Program under which incentive and nonstatutory options may be granted to employees and the Consultants Program, under which nonstatutory options may be granted to consultants of the Company. As of December 31, 2000, Eclipse had reserved a total of 5,100,000 shares of common stock for issuance under this plan. Under the plan, options may be granted at not less than fair market value (110% of fair market value for options granted to 10% shareholders), as determined by the Board of Directors. Options generally vest over a period of three years and expire ten years from date of grant (five years for options granted to 10% shareholders). No shares of common stock issued under the plan are subject to repurchase.

Directors' Stock Option Plan:

Eclipse maintains a Directors' Stock Option Plan which provides for the grant of nonstatutory options to directors who are not officers or employees of the Company. As of December 31, 2000, Eclipse had reserved 325,000 shares of common stock for issuance under this plan. Under this plan, options are granted at the trading price of the common stock at the date of grant. Options generally vest over twelve to thirty-six months and expire ten years from date of grant. No shares of common stock issued under the plan are subject to repurchase.

Employee Stock Purchase Plan:

Eclipse maintains an Employee Stock Purchase Plan, under which 578,400 shares of common stock have been reserved for issuance. Eclipse adopted the Employee Stock Purchase Plan in April 1996. The purpose of the Employee Stock Purchase Plan is to provide eligible employees of Eclipse with a means of acquiring common stock of Eclipse through payroll deductions. Eligible employees are permitted to purchase common stock at 85% of the fair market value through payroll deductions of up to 15% of an employee's compensations, subject to certain limitations. During fiscal years 2000, 1999 and 1998, approximately 172,000, 81,000, 99,000 shares, respectively, were sold through the ESPP.

Stock-Based Compensation:

The Company has adopted the disclosure only provisions of SFAS 123. Eclipse, however, continues to apply APB 25 and related interpretations in accounting for its plans. Had compensation cost for the Stock Option Plan, the Director's Stock Option Plan and the Employee Stock Purchase Plan been determined based on the fair value of the options at the grant date for awards in 2000, 1999 and 1998 consistent with the provisions of SFAS 123, Eclipse's net loss and net loss per share would have increased to the pro forma amounts indicated below (in thousands, except per share amounts):

	DECEMBER 31,		
	2000	1999	1998

Net loss as reported	$(14,609)	$(28,333)	$(47,767)
Pro forma net loss	$(17,993)	$(32,362)	$(51,213)
Basic and diluted net loss per share as reported	$ (0.48)	$ (0.99)	$ (1.77)
Pro forma basic and diluted net loss per share	$ (0.60)	$ (1.13)	$ (1.90)

The above pro-forma disclosures are not necessarily representative of the effects on reported net income for future years. The aggregate fair value and weighted average fair value per share of options granted in the years ended December 31, 2000, 1999 and 1998 were $2.5 million, $7.9 million, and $6.5 million, and $1.44, $5.25, and $5.46, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions for grants in 2000, 1999 and 1998:

ECLIPSE SURGICAL TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

	DECEMBER 31,		
	2000	1999	1998
Expected life of option	7 years	7 years	7 years
Risk-free interest rate	5.85%	5.00%	4.86%
Expected dividends	--	--	--
Expected volatility	165%	100%	97%

The aggregate fair value and weighted average fair value per share of purchase rights under the ESPP in fiscal years 2000, 1999 and 1998 was $167,000, $157,000 and $210,000, and $3.01, $3.42, and $3.90, respectively. The fair value for the purchase rights under the Employee Stock Purchase Plan is estimated using the Black-Scholes Option Pricing Model, with the following assumptions for the rights granted in 2000, 1999 and 1998:

	DECEMBER 31,		
	2000	1999	1998
Expected life	.5 years	.5 years	.5 years
Risk-free interest rate	5.85%	5.00%	4.62%
Expected dividends	--	--	--
Expected volatility	100%	100%	95%

Option activity under the Stock Option Plan and the Directors Stock

Option Plan is as follows (in thousands, except per share amounts):

	SHARES AVAILABLE FOR GRANT	OUTSTANDING OPTIONS NUMBER OF SHARES(#)	OUTSTANDING OPTIONS WEIGHTED AVERAGE PRICE PER SHARE
Balance, January 1, 1998.......	1,792	4,576	$4.37
Additional shares reserved....	320	--	--
Options granted..............	(1,243)	1,243	6.89
Options canceled.............	702	(612)	8.20
Options exercised............	--	(650)	1.37
Balance, December 31, 1998.....	1,571	4,557	4.86
Additional shares reserved....	1,225	--	--
Options granted..............	(1,494)	1,494	7.75
Options canceled.............	222	(222)	8.11
Options exercised............	--	(1,447)	5.11
Balance, December 31, 1999.....	1,524	4,382	5.35
CardioGenesis Stock Plan reserves......................	(539)	--	--
Options granted..............	(1,554)	1,554	1.17
Options canceled.............	1,019	(1,019)	7.36
Options exercised............	--	(640)	1.66
Balance, December 31, 2000.....	450	4,277	$4.99

ECLIPSE SURGICAL TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table summarizes information about the Company's stock options outstanding and exercisable under the Stock Option Plan and the Director's Stock Option Plan at December 31, 2000:

EXERCISE PRICES	OPTIONS OUTSTANDING NUMBER OUTSTANDING(#) (IN THOUSANDS)	OPTIONS OUTSTANDING WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (IN YEARS)	OPTIONS OUTSTANDING WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS EXERCISABLE NUMBER EXERCISABLE(#) (IN THOUSANDS)	OPTIONS EXERCISABLE WEIGHTED EXERCISE
$0.15-$ 0.30	88	3.62	$ 0.22	88	$ 0.22
$1.38-$ 1.44	583	6.98	0.92	202	0.46

$1.67-$ 1.67	530	4.87	1.67	530	1.67
$1.69-$ 2.29	824	7.50	1.99	121	1.99
$3.36-$ 5.88	348	8.22	3.80	203	3.90
$6.06-$ 6.94	967	7.93	6.48	635	6.51
$7.00-$ 8.74	550	7.51	8.33	371	8.28
$9.06-$15.94	389	6.52	10.17	326	10.02
	4,277	6.98	$ 4.99	2,477	$ 5.25

13. EMPLOYEE RETIREMENT PLAN:

Eclipse maintains a 401(k) plan for its employees. The plan allows eligible employees to defer up to 15% of their earnings, not to exceed the statutory amount per year on a pretax basis through contributions to the plan. The plan provides for employer contributions at the discretion of the Board of Directors, however, no such contributions were made in 2000, 1999 or 1998.

14. SEGMENT DISCLOSURES

The Company operates in the cardiovascular medical device segment. The principal markets for the Company's products are in the United States of America. International sales were in Europe and amounted to $2.2 million, $3.5 million and $3.6 million for the years ended December 31, 2000, 1999 and 1998, respectively. The international sales represent 10%, 14% and 24% of total sales for the years ended December 31, 2000, 1999 and 1998, respectively. The international sales are denominated in US dollars.

15. INTEREST AND OTHER INCOME:

Interest and other income consists of the following (in thousands):

	YEARS ENDED DECEMBER 31,		
	2000	1999	1998
Interest and other income	$ 400	$ 796	$3,004
Gain on investment in MicroHeart Holdings, Inc.	--	--	400
Gain on sale of marketable securities	--	5	50
	$ 400	$ 801	$3,454

16. INCOME TAXES:

Significant components of Eclipse's deferred tax assets are as follows (in thousands):

	DECEMBER 31	
	2000	1999
Net operating losses	$ 50,734	$ 43,914
Research and development and other credits	3,697	4,284
Capitalized research and development	806	1,858
Reserves	2,038	2,705
Accrued liabilities	1,118	2,116
Depreciation	259	402
Other	763	1,018
Net deferred tax asset	59,415	56,297
Less valuation allowance	(59,415)	(56,297)
Net deferred tax assets	$ --	$ --

The Company has established a valuation allowance to the extent of its deferred tax asset since it is not certain that a benefit can be realized in the future due to the Company's recurring operating losses.

As of December 31, 2000, the Company had federal and state net operating loss carryforwards of approximately $137 million and $62 million, respectively, to offset future taxable income. In addition, the Company had federal and state credit carryforwards of approximately $2,501,000 and $1,195,000 available to offset future tax liabilities. The Company's net operating loss carryforwards, as well as credit carryforwards, will expire at various dates beginning in 2001 through 2020, if not utilized.

The Internal Revenue Code limits the use of net operating loss and tax credit carryforwards in certain situations where changes occur in the stock ownership of a company. The Company believes that the sale of common stock in its initial public offering and the merger with CardioGenesis resulted in changes in ownership which could restrict the utilization of the carryforwards.

17. RELATED PARTY TRANSACTIONS:

The Company paid $0, $3,875 and $445,000 for consulting fees and product to certain stockholders during the years ended December 31, 2000, 1999 and 1998, respectively.

18. SUBSEQUENT EVENTS:

In March 2001, the Company sold 898,202 shares of common stock to Acqua Wellington North American Equities Fund, Ltd. ("Acqua Wellington") at a negotiated purchase price of $1.1133 per share pursuant to the common stock purchased agreement between Eclipse Surgical Technologies, Inc. and Acqua Wellington dated August 17, 2000. The Company did not pay any other compensation in conjunction with the sale of our common stock.

In April 2001, the Company sold 2,000,000 shares of common stock to a governmental entity at a negotiated purchase price of $1.00 per share. The Company did not pay any other compensation in conjunction with the sale of our common stock. These securities carry registration rights. If a registration statement is not declared effective by the SEC on or before July 12, 2001, the Company will be required to pay liquidated damages in the amount of 0.25% of the total purchase price of the shares for each week after July 12, 2001 that the registration statement is not declared effective. The purchaser also has certain anti-dilution rights that are effective for 90 days following the purchase of the stock. As a condition of the sale, the Company amended its bylaws to

ECLIPSE SURGICAL TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

preclude, absent shareholder approval, the granting of any stock options with an exercise price which is below the fair market value of the underlying stock on the date of grant, the repricing of any stock options, the issuance of any security convertible, exercisable or exchangeable into shares of common stock of the Company having a conversion, exercise or exchange price per share which is subject to downward adjustment based on the market price of the common stock at the time of conversion, exercise or exchange of such security into the Company's common stock, or enter into any equity line or similar agreement or arrangement or any agreement to sell common stock at a price fixed after the date of the agreement.

In April 2001, the Company received a non-binding letter of intent from a business credit financing company regarding an asset-based financing agreement which will provide an estimated $1,000,000 of additional financing based upon our current levels of qualified domestic accounts receivable which will serve as collateral.

ECLIPSE SURGICAL TECHNOLOGIES, INC.

SCHEDULE II -- VALUATION AND QUALIFYING ACCOUNTS
(IN THOUSANDS)

	BALANCE AT BEGINNING OF PERIOD	ADDITIONS(1)	DEDUCTIONS(2)	BALANCE AT END OF PERIOD
Allowance for doubtful accounts:				
Year ended December 31, 1998				

Allowance for doubtful accounts	$ 1,727	$ 1,017	$ 75	$ 2,669
Year ended December 31, 1999				
Allowance for doubtful accounts	$ 2,669	$ 1,377	$ 2,170	$ 1,876
Year ended December 31, 2000				
Allowance for doubtful accounts	$ 1,876	$ 620	$ 1,700	$ 796
Inventory reserve:				
Year ended December 31, 1998				
Inventory reserve	$ 432	$ 68	$ 97	$ 403
Year ended December 31, 1999				
Inventory reserve	$ 403	$ 1,782	$ 187	$ 1,998
Year ended December 31, 2000				
Inventory reserve	$ 1,998	$ 673	$ 491	$ 2,180
Warranty reserve:				
Year ended December 31, 1998				
Warranty reserve	$ 78	$ 100	$ --	$ 178
Year ended December 31, 1999				
Warranty reserve	$ 178	$ 114	$ 67	$ 225
Year ended December 31, 2000				
Warranty reserve	$ 225	$ 95	$ 162	$ 158
Valuation allowance:				
Year ended December 31, 1998				
Valuation allowance	$27,391	$19,342	$ --	$46,733
Year ended December 31, 1999				
Valuation allowance	$46,733	$ 9,564	$ --	$56,297
Year ended December 31, 2000				
Valuation allowance	$56,297	$ 3,118	$ --	$59,415

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(1) Charged to costs and expenses.
(2) Amounts written off against the reserve.

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE YEAR ENDED DECEMBER 31, 2000 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.